UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

JEFFREY PROVENZANO, THOMAS BENJAMIN and MONICA AGOSTO, on behalf of themselves and all others similarly situated,

Plaintiffs,

-against-

THE THOMSON CORPORATION and WEST PUBLISHING CORPORATION d/b/a BARBRI,

Defendants.

Civil Action No. 1:07-CV-0746, LEK/RFT

COMPENDIUM OF AUTHORITY IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS AVAILABLE ONLY ON COMPUTERIZED DATABASES

Table of Cases

1. ATSI Communications, Inc. v. Shaar Fund, Ltd. 2007 WL 1989336 (C.A.2 (N.Y.))

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ATSI Communications, Inc. v. Shaar Fund, Ltd.
C.A.2 (N.Y.),2007.
Only the Westlaw citation is currently available.

United States Court of Appeals,Second Circuit.

ATSI COMMUNICATIONS, INC., a Delaware Corporation, Plaintiff-Appellant,

v.

The SHAAR FUND, LTD., Shaar Advisory Services, N.V., RGC International Investors, LDC, Rose Glen Capital Management, L.P., Corporate Capital Management, Intercaribbean Services Ltd., Citco Fund Svcs., Luc Hollman, Sam Levinson, Hugo Van Neutegem, Declan Quilligan, Wayne Bloch, Gary Kaminsky, Steve Katznelson, Trimark Securities, Inc., Levinson Capital Management, and W.J. Langeveld, Defendants-Appellees,

Marshall Capital Services, LLC., Jesup & Lamont Structured Finance Group, MG Security Group, Inc., Crown Capital Corporation, John Does 1-50, Kenneth E. Gardiner, Nathan Lihon, and Sei Investment Co., Defendants.

ATSI Communications, Inc., a Nevada Corporation, Plaintiff-Appellant,

v.

Uri Wolfson, Defendant-Appellee,
Sam Levinson, Defendant.

Docket Nos. 05-5132-cv, 05-2593-cv.

Argued: Nov. 29, 2006.
Decided: July 11, 2007.

Background: Corporation filed securities fraud action alleging that investors defrauded it into selling multiple series of its convertible preferred securities to entities they controlled. The United States District Court for the Southern District of New York, Lewis A. Kaplan, J., 357 F.Supp.2d 712, dismissed action. Corporation appealed.

Holdings: The Court of Appeals, John M. Walker, Jr., Circuit Judge, held that:

(1) purchasing floorless convertible security is not, by itself or when coupled with short selling, inherently manipulative in violation of federal securities laws prohibiting fraud;

(2) corporation did not adequately plead scienter on its manipulation claim;

(3) strong inference of scienter is not raised by alleging that legitimate investment vehicle, such as convertible preferred stock, creates opportunity for profit through manipulation;

(4) merger clauses barred corporation's causes of action that were based on alleged misrepresentations made by investors during negotiations preceding corporation's sale of multiple series of its convertible preferred securities to entities controlled by investors;

(5) generalized allegation that investors had engaged in death spiral financing, as indicated by declining stock prices of unspecified companies in which they invested, combined with detailed definition of how death spiral financing worked, did not state fraud with particularity or satisfy PSLRA's requirement of stating facts on which belief was based;

(6) corporation did not sufficiently plead fraud by simply providing method for investors to discover underlying details, by detailing how unspecified companies could be found, in which investors allegedly provided death spiral financing, by searching publicly-available database, or by contending that investors had personal knowledge of what investments they made and when stock prices of those investments declined;

(7) corporation did not adequately plead fraud by pointing to drop in stock prices of investors' other risky investments; and

(8) proximate causal link did not exist between corporation's losses and investor's misrepresentation in securities purchase agreement that it was accredited.

Affirmed.

[1] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
 170AVII Pleadings and Motions
  170AVII(A) Pleadings in General
   170Ak633 Certainty, Definiteness and Particularity
    170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

A federal securities fraud complaint based on misstatements must (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[2] Securities Regulation 349B ⚷60.51

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 k. In General. Most Cited Cases

A plaintiff may satisfy the PSLRA requirement of pleading scienter in an action for money damages requiring proof of a particular state of mind by alleging facts: (1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness. Private Securities Litigation Reform Act of 1995, § 101(b)(2), 15 U.S.C.A. § 78u-4(b)(2).

[3] Securities Regulation 349B ⚷60.51

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 k. In General. Most Cited Cases

When determining whether the pleaded facts give rise to a strong inference of scienter, in a federal securities fraud action subject to the PSLRA, a court must take into account plausible opposing inferences; for an inference of scienter to be strong, a reasonable person must deem it cogent and at least as compelling as any opposing inference one could draw from the facts alleged. Private Securities Litigation Reform Act of 1995, § 101(b)(2), 15 U.S.C.A. § 78u-4(b)(2).

[4] Securities Regulation 349B ⚷60.45(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.45 Scienter, Intent, Knowledge, Negligence or Recklessness
349Bk60.45(1) k. In General. Most Cited Cases

In a Rule 10b-5 action, scienter requires a showing of intent to deceive, manipulate, or defraud, or reckless conduct. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[5] Securities Regulation 349B ⚷60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price Manipulation. Most Cited Cases

In the context of a claim of federal securities fraud, " manipulation" connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[6] Securities Regulation 349B ⚷60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price Manipulation. Most Cited Cases

A market manipulation claim under federal securities laws prohibiting fraud cannot be based solely upon misrepresentations or omissions; there must be some market activity, such as wash sales, matched orders, or rigged prices. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[7] Securities Regulation 349B ⚷60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price

Manipulation. Most Cited Cases

To be actionable as a manipulative act in violation of federal securities laws prohibiting fraud, short selling must be willfully combined with something more to create a false impression of how market participants value a security. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[8] Securities Regulation 349B ⚷60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price Manipulation. Most Cited Cases

Purchasing a floorless convertible security is not, by itself or when coupled with short selling, inherently manipulative in violation of federal securities laws prohibiting fraud. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[9] Securities Regulation 349B ⚷60.25

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.25 k. Fraud on the Market; Price Manipulation. Most Cited Cases

Market manipulation in violation of federal securities laws prohibiting fraud requires a plaintiff to allege (1) manipulative acts; (2) damage (3) caused by reliance on an assumption of an efficient market free of manipulation; (4) scienter; (5) in connection with the purchase or sale of securities; (6) furthered by the defendant's use of the mails or any facility of a national securities exchange. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[10] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

Because a claim for market manipulation is a claim for fraud, it must be pled with particularity. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[11] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

Securities Regulation 349B ⚷60.51

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 k. In General. Most Cited Cases

At the early stages of federal securities litigation claiming market manipulation, a plaintiff need not plead manipulation to the same degree of specificity as a plain misrepresentation claim because a claim of manipulation can involve facts solely within the defendant's knowledge. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

At the early stages of federal securities litigation claiming market manipulation, a plaintiff need not plead manipulation to the same degree of specificity as a plain misrepresentation claim because a claim of manipulation can involve facts solely within the defendant's knowledge. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[12] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

A market manipulation complaint under federal securities laws must plead with particularity the nature, purpose, and effect of the fraudulent conduct and the roles of the defendants; this test will be satisfied if the complaint sets forth, to the extent possible, what manipulative acts were performed, which defendants performed them, when the manipulative acts were performed, and what effect the scheme had on the market for the securities at issue. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[13] Securities Regulation 349B 60.51

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 k. In General. Most Cited Cases

Under the PSLRA, a manipulation complaint under federal securities laws must plead with particularly facts giving rise to a strong inference that the defendant intended to deceive investors by artificially affecting the market price of securities. Private Securities Litigation Reform Act of 1995, § 101(b)(2), 15 U.S.C.A. § 78u-4(b)(2).

[14] Securities Regulation 349B 60.51

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 k. In General. Most Cited Cases

Corporation did not adequately plead scienter on its manipulation claim subject to PSLRA against investors who purchased multiple series of corporation's convertible preferred securities through entities they controlled, on allegations of high-volume selling of corporation's stock with coinciding drops in stock price, trading patterns around conversion time, stock's negative reaction to positive news, and volume of trades in excess of settlement during 10 day period, since corporation did not offer specific allegations that defendants did anything to manipulate market. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Private Securities Litigation Reform Act of 1995, § 101(b)(2), 15 U.S.C.A. § 78u-4(b)(2); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[15] Securities Regulation 349B 60.51

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 k. In General. Most Cited Cases

A strong inference of scienter is not raised by alleging that a legitimate investment vehicle, such as a convertible preferred stock, creates an opportunity for profit through manipulation. Private Securities Litigation Reform Act of 1995, § 101(b)(2), 15 U.S.C.A. § 78u-4(b)(2).

[16] Securities Regulation 349B 60.51

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 k. In General. Most Cited Cases

Corporation did not adequately plead scienter on its manipulation claim subject to PSLRA against principal market maker in corporation's stock on allegations that market maker knew or should have known of manipulation and that corporation believed that market maker was cooperating broker-dealer. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Private Securities Litigation Reform Act of 1995, § 101(b)(2), 15 U.S.C.A. § 78u-4(b)(2); 17 C.F.R. § 240.10b-5.

[17] Securities Regulation 349B 60.18

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.18 k. In General. Most Cited Cases

To state a claim under Rule 10b-5 for misrepresentations, a plaintiff must allege that the defendant (1) made misstatements or omissions of material fact, (2) with scienter, (3) in connection with the purchase or sale of securities, (4) upon which the plaintiff relied, and (5) that the plaintiff's reliance was the proximate cause of its injury. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[18] Securities Regulation 349B ⚷60.48(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance
349Bk60.48(1) k. In General. Most Cited Cases

On a federal securities fraud claim, where the plaintiff is a sophisticated investor and an integrated agreement between the parties does not include the misrepresentation at issue, the plaintiff cannot establish reasonable reliance on that misrepresentation. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[19] Securities Regulation 349B ⚷60.48(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance
349Bk60.48(1) k. In General. Most Cited Cases

Merger clauses barred corporation's causes of action that were based on alleged misrepresentations made by investors during negotiations preceding corporation's sale of multiple series of its convertible preferred securities to entities controlled by investors, since corporation was sophisticated investor having engaged in those private placements of complex securities. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[20] Securities Regulation 349B ⚷60.53

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.53 k. Misrepresentation. Most Cited Cases

Corporation which alleged, on information and belief, fraudulent misrepresentation by investor in promising, in securities purchase agreement, to not enter short position prior to closing or cover short position entered into prior to execution of agreement using converted common stock did not sufficiently allege that representation was false when made, as required to state federal securities fraud claim. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[21] Securities Regulation 349B ⚷60.27(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.17 Manipulative, Deceptive or Fraudulent Conduct
349Bk60.27 Misrepresentation
349Bk60.27(1) k. In General. Most Cited Cases

While the failure to carry out a promise in connection with a securities transaction might constitute breach of contract, it does not constitute fraud unless, when the promise was made, the defendant secretly intended not to perform or knew that he could not perform. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[22] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

Securities Regulation 349B ⚷60.51

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.50 Pleading
349Bk60.51 k. In General. Most Cited Cases

Generalized allegation that investors had engaged in death spiral financing, as indicated by declining stock prices of unspecified companies in which they invested, combined with detailed definition of how death spiral financing worked, did not state fraud with particularity or satisfy PSLRA's requirement of stating facts on which belief was based, since complaint did not specify which companies experienced decline in share price or when they experienced decline other than that they occurred within one year of unspecified time of investment, and complaint did not allege with particularity what, if anything, investors did to cause decline. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Private Securities Litigation Reform Act of 1995, § 101(b)(4), 15 U.S.C.A. § 78u-4(b)(4); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; 17 C.F.R. § 240.10b-5.

Generalized allegation that investors had engaged in death spiral financing, as indicated by declining stock prices of unspecified companies in which they invested, combined with detailed definition of how death spiral financing worked, did not state fraud with particularity or satisfy PSLRA's requirement of stating facts on which belief was based, since complaint did not specify which companies experienced decline in share price or when they experienced decline other than that they occurred within one year of unspecified time of investment, and complaint did not allege with particularity what, if anything, investors did to cause decline. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Private Securities Litigation Reform Act of 1995, § 101(b)(4), 15 U.S.C.A. § 78u-4(b)(4); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; 17 C.F.R. § 240.10b-5.

[23] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

Corporation did not sufficiently plead fraud in action alleging violation of federal securities laws by simply providing method for investors to discover underlying details, by detailing how unspecified companies could be found, in which investors allegedly provided death spiral financing, in search of publicly-available database, or by contending that investors had personal knowledge of what investments they made and when stock prices of those investments declined; if corporation had access to details necessary to make those allegations, it had to plead them and not just tell investors to go find them. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.; 17 C.F.R. § 240.10b-5.

[24] Federal Civil Procedure 170A ⚷636

170A Federal Civil Procedure
170AVII Pleadings and Motions
170AVII(A) Pleadings in General
170Ak633 Certainty, Definiteness and Particularity
170Ak636 k. Fraud, Mistake and Condition of Mind. Most Cited Cases

Corporation did not adequately plead fraud, in action alleging violation of federal securities laws, by pointing to drop in stock prices of investors' other risky investments; no inference of sabotage was available from circumstance that some, or many, risky investments came to nothing, particularly where allegations did not point to any specific actions by investor with respect to those investments. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5; Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

[25] Securities Regulation 349B ⚷60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. Most Cited Cases

Proximate causal link did not exist under PSLRA between investor's misrepresentation in securities purchase agreement that it was accredited and corporation's losses through tremendous decline in its share price, allegedly brought about through death spiral financing, impairing its access to capital and its viability as business, and through its sale of its own stock at depressed prices, after corporation sold multiple series of its convertible preferred securities to entities controlled by investor. Private Securities Litigation Reform Act of 1995, § 101(b)(4), 15 U.S.C.A. § 78u-4(b)(4).

[26] Securities Regulation 349B ⚷60.47

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.47 k. Causation; Existence of Injury. Most Cited Cases

On a federal securities fraud claim under the PSLRA, a plaintiff is required to prove both transaction causation, also known as reliance, and loss causation; transaction causation only requires allegations that but for the claimed misrepresentations or omissions, the plaintiff would not have entered into the detrimental securities transaction, and loss causation is the proximate causal link between the alleged misconduct and the plaintiff's economic harm. Private Securities Litigation Reform Act of 1995, § 101(b)(4), 15 U.S.C.A. § 78u-4(b)(4).

[27] Limitation of Actions 241 100(12)

241 Limitation of Actions
241II Computation of Period of Limitation
241II(F) Ignorance, Mistake, Trust, Fraud, and Concealment or Discovery of Cause of Action
241k98 Fraud as Ground for Relief
241k100 Discovery of Fraud
241k100(12) k. What Constitutes Discovery of Fraud. Most Cited Cases

One year statute of limitations for corporation's pre-Sarbanes-Oxley Act federal securities fraud claim against investor, for engaging in bait-and-switch scheme by first promising in its draft term sheet to invest $10 million and then offering only $2.5 million at closing, began to run when corporation signed closing documents, since that is when corporation learned of alleged falsity of representation. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[28] Securities Regulation 349B 60.48(1)

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)7 Fraud and Manipulation
349Bk60.43 Grounds of and Defenses to Liability
349Bk60.48 Reliance
349Bk60.48(1) k. In General. Most Cited Cases

Investor's promise in its draft term sheet to invest $10 million in corporation was not false, and corporation could not have relied on promise, in context of claim of fraud under federal securities laws, despite investor's offer of only $2.5 million at closing, since term sheet expressly stated that investor's " obligation to fund is subject to satisfactory due diligence, in [investor's] sole discretion." Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b-5.

[29] Securities Regulation 349B 35.15

349B Securities Regulation
349BI Federal Regulation
349BI(C) Trading and Markets
349BI(C)1 In General
349Bk35.15 k. Controlling Persons. Most Cited Cases

To establish a prima facie case of control person liability, a plaintiff must show (1) a primary violation by the controlled person, (2) control of the primary violator by the defendant, and (3) that the defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud.

[30] Federal Courts 170B 817

170B Federal Courts
170BVIII Courts of Appeals
170BVIII(K) Scope, Standards, and Extent
170BVIII(K)4 Discretion of Lower Court
170Bk817 k. Parties; Pleading. Most Cited Cases

A district court's denial of leave to amend is reviewed for abuse of discretion.

[31] Federal Civil Procedure 170A 1838

170A Federal Civil Procedure
170AXI Dismissal
170AXI(B) Involuntary Dismissal
170AXI(B)5 Proceedings
170Ak1837 Effect
170Ak1838 k. Pleading Over. Most Cited Cases

District court did not abuse its discretion in declining to grant further leave to amend in federal securities fraud action, where corporation had submitted three amended complaints and district court already had dismissed action's first amended complaint for failure to meet pleading requirements on many grounds similar to its final dismissal for failure to state claim upon which relief could be granted. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rules 12(b)(6), 15, 28 U.S.C.A.; 17 C.F.R. § 240.10b-5.

Appeals from judgments of the United States District Court for the Southern District of New York (Lewis A. Kaplan, *Judge*), dismissing plaintiff ATSI Communications, Inc.'s complaints alleging, inter alia, securities fraud in violation of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 357 F.Supp.2d 712 (S.D.N.Y.2005). AFFIRMED.

Thomas I. Sheridan III (Andrea Bierstein, Melissa C. Welch, on the brief), Hanly Conroy Bierstein & Sheridan LLP, New York, NY, for ATSI Communications, Inc.

Jonathan M. Sperling (Amanda J. Gourdine, on the brief), Covington & Burling, New York, NY, for The Shaar Fund, Ltd., Shaar Advisory Services, N.V., Levinson Capital Management, Sam Levinson, and Uri Wolfson.
J. Kevin McCarthy (Joanne L. Monteavaro, on the brief), Wilmer Cutler Pickering Hale and Door LLP, New York, NY, for Rose Glen Capital Management, L.P., RGC International Investors, LDC, Wayne Bloch, Gary Kaminsky, and Steven Katznelson.
David G. Cabrales (W. Scott Hastings, Jeffrey A. Logan, on the brief), Locke Liddell & Sapp LLP, Dallas, TX; Cahill Gordon & Reindel LLP (Thorn Rosenthal, Janet A. Beer, on the brief), New York, NY, for Trimark Securities, Inc.
Michael J. Dell (Elaine Golin, on the brief), Kramer Levin Naftalis & Frankel LLP, New York, NY, for Citco Fund Services (Curaçao) N.V., InterCaribbean Services, Ltd., Hugo van Neutegem, Wim Langeveld, Luc Hollman, and Declan Quilligan.
Berkman, Henoch, Peterson & Peddy, P.C. (Ronald M. Terenzi, on the brief), Garden City, NY, for Corporate Capital Management.

Before JACOBS, Chief Judge, WALKER and RAGGI, Circuit Judges.
JOHN M. WALKER, JR., Circuit Judge.
***1** These appeals arise from judgments of the United States District Court for the Southern District of New York (Lewis A. Kaplan, *Judge*), dismissing plaintiff ATSI Communications, Inc.'s (" ATSI") complaints under Fed.R.Civ.P. 12(b)(6) in two separate actions arising from the same events. *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.,* 357 F.Supp.2d 712 (S.D.N.Y.2005). ATSI alleges that the defendants made misrepresentations in connection with securities transactions and engaged in market manipulation in violation of § 10(b) of the Securities Exchange Act of 1934 (" Exchange Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, or were liable as control persons under § 20(a) of the Exchange Act, 15 U.S.C. § 78t(a). ATSI claims that the defendants fraudulently induced it to sell to them its convertible preferred stock. The defendants then aggressively short sold ATSI's common stock and converted the preferred stock to cover their short positions. The alleged consequence was a " death spiral" in the price of ATSI's stock and enormous profit for the defendants.

We affirm the judgments of the district court.

BACKGROUND

The following facts are taken from ATSI's complaints and supporting documents, which we must assume to be true in reviewing a Fed.R.Civ.P. 12(b)(6) dismissal. *See Rothman v. Gregor,* 220 F.3d 81, 88 (2d Cir.2000).

A. ATSI and Its Efforts to Raise Money

ATSI was founded in December 1993 and hoped to become a leading provider of retail communications services in Mexico in the wake of the deregulation and privatization in Latin America's telecommunications markets. It never turned a profit. By 1999, ATSI needed an infusion of capital to expand its U.S. customer base and further develop its telephone network in Mexico.

To raise money, ATSI issued four series of cumulative convertible preferred stock (" Preferred Stock"): Series B, C, D, and E. Each transaction included a Securities Purchase Agreement, a Certificate of Designation, and a Registration Rights Agreement. Each series included a risk-mitigating conversion feature that worked as follows. Upon conversion, a " Market Price" was calculated as the average of the lowest five closing bid prices during the ten-day period preceding the conversion date. The " Conversion Price" was calculated as the lesser of (1) the closing bid price on a trading day fixed by the Certificate of Designation and (2) the Market Price discounted by 17% to 22% depending upon the series. ATSI would then issue a number of shares of common stock equal to (1) the number of shares of Preferred Stock to be converted (2) multiplied by the Preferred Stock's stated value of $1,000 per share (3) divided by the Conversion Price. Because there is no limit on the number of common shares into which the Preferred Stock could convert, securities such as these are called " floorless" convertibles. The obvious inference from ATSI's sale of these securities is that these unfavorable terms were necessary to attract investors because ATSI was continuously losing money. In fact, ATSI acknowledged that in light of its financial condition, it might " not be able to raise money on any acceptable terms." American Telesource International, Inc., Annual Report (Form 10-K), at 16 (July 31, 2000).

1. Sales to the Levinson Defendants

***2** On a " road show" in Dallas, Texas in March 1999, defendant Corporate Capital Management (" CCM") introduced ATSI executives to defendant Sam Levinson, the managing director of Levinson Capital and the Shaar Fund. Shaar Advisory Services, N.V. (" Shaar Advisory") served as executive officer and general partner of the Shaar Fund. Defendant Uri Wolfson controls the Shaar Fund. Collectively, Levinson, Levinson Capital, the Shaar Fund, and Shaar Advisory constitute the " Levinson

Defendants."

During a May 1999 telephone conversation, CCM told ATSI that the Shaar Fund had invested in several strong, successful companies and that the Levinson Defendants were interested in ATSI's long-term growth. During a June meeting, Levinson told ATSI, inter alia, that the Levinson Defendants sought a long-term investment in ATSI and would not engage in any activity to depress its stock. ATSI claims that all of these representations were false and misleading because CCM and Levinson knew otherwise and the Levinson Defendants were actually market manipulators that profited at the expense of the companies in which they invested.

Over the next six months, ATSI entered into the following securities transactions with the Shaar Fund.

Transaction Date	# of Preferred Shares Purchased	# of Warrants Purchased	Total Purchase Price
July 2, 1999	2,000 Series B	50,000	$2,000,000
Sept. 24, 1999	500 Series C	20,000	$500,000
Feb. 22, 2000	3,000 Series D	150,000	$3,000,000

The Securities Purchase Agreement for each transaction included written representations that:

1. The Shaar Fund was an " accredited investor" within the meaning of Rule 501 of Regulation D under the Securities Act of 1933; and

2. " Neither [the Shaar Fund] nor its affiliates nor any person acting on its or their behalf has the intention of entering, or will enter into, prior to the closing, any put option, short position, or other similar instrument or position with respect to the Common Stock [of ATSI] and neither [the Shaar Fund] nor any of its affiliates nor any person acting on its or their behalf will use at any time shares of Common Stock acquired pursuant to this Agreement to settle any put option, short position or other similar instrument or position that may have been entered into prior to the execution of this Agreement."

ATSI claims that these representations were false because (1) the Shaar Fund's net worth was not high enough to meet the requirements for being an accredited investor and (2) the Shaar Fund intended to engage, and did engage, in short selling and manipulation of ATSI's stock before, during, and after entering into these agreements.

The Registration Rights Agreement in each transaction contained a merger clause stating that:

There are no restrictions, promises, warranties, or undertakings, other than those set forth or referred to herein. This Agreement, the Securities Purchase Agreement, the Escrow Instructions, the Preferred Shares and the Warrants supersede all prior agreements and undertakings among the parties hereto with respect to the subject matter hereof.

***3** The Registration Rights Agreements contemplated that the Shaar Fund would soon sell its converted common stock into the public markets. They required ATSI to use its " best efforts" to register the common stock to be issued upon conversion of the Preferred Stock within 90 days of closing and to take all reasonable steps to help the Shaar Fund sell the common stock. They also imposed, at most, a 90-day holding period before the Shaar Fund could convert its Preferred Stock. The only restriction upon the Shaar Fund's ability to sell the common stock was if ATSI notified it of a material misstatement in the stock's prospectus.

2. Sales to Rose Glen

In September 1999, ATSI decided to issue $15 million in its equity to fund an acquisition. Defendant Crown Capital Corporation (" Crown Capital"), acting as placement agent, recommended defendants RGC International Investors, LDC, and Rose Glen Capital Management, L.P. Defendants Wayne Bloch, Gary Kaminsky, and Steve Katznelson were employees of Rose Glen Capital Management. We refer collectively to all of these defendants as " Rose Glen."

During negotiations, Rose Glen allegedly made false verbal representations similar to those made by the Levinson Defendants.

On September 27, 2000, Rose Glen submitted a draft term sheet to ATSI offering a $10 million investment. ATSI claims that it then fell victim to a bait-and-switch when, on October 16, 2000, Rose Glen submitted closing documents providing for only a $2.5 million investment in Series E Preferred Stock, with a promise of further investment of up to $10 million if certain conditions were met. ATSI says it was forced to accept these terms because it was required to pay $2 million to vendors in Mexico the next day. ATSI sold Rose Glen additional Series E Preferred Stock in March and July of 2001.

The Purchase Agreement pursuant to which these securities were sold included two representations by Rose Glen that ATSI claims to be false on the same basis as the Levinson representations:

1. Rose Glen was an accredited investor; and

2. Rose Glen was purchasing the Preferred Stock and common stock issuable upon conversion:

for its own account and not with a present view towards the public sale or distribution thereof except pursuant to sales registered or exempted from registration under the 1933 Act; *provided, however* that by making the representation herein, the Buyer does not agree to hold any of the Securities for any minimum or other specific term and reserves the right to dispose of the Securities at any time in accordance with or pursuant to a registration statement or exemption under the 1933 Act.

The Registration Rights Agreements also contained a merger clause similar to the one in the Shaar Fund transaction documents.

B. The " Death Spiral" Financing Manipulation Scheme

In addition to these misrepresentations, ATSI claims that all of the defendants manipulated the market in ATSI's common stock by bringing about a " death spiral" in the price of ATSI's common stock. The scheme, as alleged, worked as follows. The shareholder would short sell the victim's common stock to drive down its price.FN1 He then converts his convertible securities into common stock and uses that common stock to cover his short position. The convertible securities allow a manipulator to increase his profits by allowing him to cover with discounted common shares not obtained on the open market, to rely on the convertible securities as a hedge against the risk of loss, and to dilute existing common shares, resulting in a further decline in stock price. ATSI was aware of the risk of dilution; for example, it disclosed in the registration statement on its Form S-3 that it expected the Shaar Fund to convert shortly after the registration became effective and that future issuances of Preferred Stock would put downward pressure on and dilute its common stock.

*4 ATSI accuses the Levinson Defendants, Wolfson, and Rose Glen of deliberately causing a " death spiral" in its common stock. The Shaar Fund began converting its Preferred Stock shortly after it was contractually permitted to do so. During the first two quarters of fiscal year 2000, it had converted all of its Series B shares into approximately 2.6 million common shares. Although ATSI's April 14, 2000 Form S-3 states that the Shaar Fund sold the common stock, the complaints do not allege any such sales. Between December 12, 2000 and January 23, 2002, the Shaar Fund converted its Series D shares into 8,331,454 shares of ATSI common stock. Between March 8, 2001 and August 14, 2002, Rose Glen converted its Preferred Stock into over nineteen million shares of common stock.

ATSI does not allege any specific acts of short selling by the Levinson Defendants, but it includes circumstantial allegations. It alleges that searches in the SEC's Edgar database reveal that of the 38 companies that reported the Levinson Defendants as investors, 30 experienced stock price declines indicative of a " death spiral" financing scheme. Its allegations against Rose Glen are of like kind.

ATSI also relies on the magnitude and timing of changes in its stock price and trading volume. At the time of the Series B transaction in July 1999, its stock traded at $1.50 per share. Two months later, it traded at $1.08 per share. In February 2000, the Series D Preferred Stock purchase was preceded by a significant increase in the daily trading volume of ATSI's shares and a dramatic rise in ATSI's share price to $9 per share (perhaps not coincidentally as ATSI listed its stock on the American Stock Exchange (" AMEX") during that period). April 2000 saw massive stock sales and large price declines in ATSI's stock. For example, between April 13, 2000 and April 18, 2000-during which time ATSI filed a registration statement for the common stock into which the Series C and D Preferred Stock would convert-the price fell from $6 .50 per share to $3.62 per share on heavy volume. ATSI claims that these price movements could only have resulted from sales by the Levinson Defendants, despite Levinson's claim that the Shaar Fund was not selling.

ATSI's stock price climbed up to $6 per share by early-June 2000. On September 8, 2000, ATSI's registration of common stock for the Series C and D Preferred Stock became effective and, by November 28, 2000, its price had fallen to $0.75 per share, and plummeted to $0.09 per share on August 16, 2002.

In addition to these price fluctuations, ATSI relies more specifically on price movements and trading volume around the time that the Shaar Fund and Rose Glen converted their Series D and E Preferred Stock, which worked to their benefit. ATSI further points to instances where its stock price reacted negatively to positive news. ATSI also points to a 10-trading-day period between December 31, 2002 and January 14, 2003 in which Depository Trust Company records show that over eight million shares were traded in excess of settlement, which it claims could only result from sham trading.

C. Other Defendants

***5** ATSI alleges that any manipulation had to involve defendant Trimark Securities, Inc. (" Trimark"), which served as the principal market maker in ATSI's stock.

ATSI also alleges that several defendants, hereinafter referred to as the " Citco Defendants," caused the Shaar Fund to engage in the charged misconduct. Defendant Citco Fund Services (Curaçao) N.V. is the parent of defendant InterCaribbean Services, Ltd., the Shaar Fund's sole director. Declan Quilligan is a director of InterCaribbean. W.J. Langeveld, Hugo Van Neutegem, and Luc Hollman served as Managing Directors of Shaar Advisory.

D. ATSI's Demise

Telecom stocks were generally hard-hit during the period in which ATSI alleges manipulation. Between February 22, 2000 (the date on which ATSI issued the Series D Preferred Stock) and October 31, 2002 (the date on which ATSI filed its first suit), the AMEX North American Telecom Index (of which ATSI's stock was not a component) dropped by 73%. When ATSI filed its complaint, its stock traded at $0.02 per share. Its financial impairment has rendered it unable to raise capital to maintain or expand its business.

E. ATSI's Claims and Procedural History

ATSI claims that the Levinson Defendants, Wolfson, Langeveld, Rose Glen, CCM, and Crown Capital are liable for misrepresentations under § 10(b) and Rule 10b-5; that these same defendants and Trimark are also liable for market manipulation in violation of Rule 10b-5; and that the Citco Defendants and others not relevant to this appeal are liable as control persons under § 20(a). ATSI also asserts various state law claims.

ATSI filed its complaint in the first suit in October 2002 against all defendants except Wolfson (" *ATSI I* "). In March 2004, the district court dismissed ATSI's first amended complaint against the Levinson Defendants and Rose Glen for failing to satisfy the pleading requirements of Fed.R.Civ.P. 9(b) and the Private Securities Litigation Reform Act (" PSLRA"), 15 U.S.C. § 78u-4(b). It dismissed as to the other defendants for improper service and lack of personal jurisdiction. Second and third amended complaints followed and, in July 2004, ATSI filed a largely identical complaint against Levinson and Wolfson in a separate suit (" *ATSI II* "). In February 2005, the district court dismissed the third amended complaint in *ATSI I* under Fed.R.Civ.P. 12(b)(6) with prejudice for again failing to satisfy Rule 9(b) and the PSLRA's pleading requirements. *See* *ATSI Commc'ns,* 357 F.Supp.2d at 720. Because subject matter jurisdiction was based solely on ATSI's federal claims, the district court did not separately consider the state law causes of action. The district court entered judgment under Fed.R.Civ.P. 54(b), and the parties in *ATSI II* stipulated to dismissal based on the district court's order in *ATSI I.*

ATSI's timely appeals followed.

DISCUSSION

I. Legal Standards

We review a district court's dismissal of a complaint pursuant to Fed.R.Civ.P. 12(b)(6) de novo, accepting all factual allegations in the complaint and drawing all reasonable inferences in the plaintiff's favor. *Ganino v. Citizens Utils. Co.,* 228 F.3d 154, 161 (2d Cir.2000). In addition, we may consider any written instrument attached to the complaint, statements or documents incorporated into the complaint by reference, legally required public disclosure documents filed with the SEC, and documents possessed by or known to the plaintiff and upon which it relied in bringing the suit. *Rothman,* 220 F.3d at 88. To survive dismissal, the plaintiff must provide the grounds upon which his claim rests through factual allegations sufficient " to raise a right to relief above the speculative level." [FN2] *Bell Atl. Corp. v. Twombly,* --- U.S. ----, ----, 127 S.Ct. 1955, 1965, --- L.Ed.2d ----, ---- (2007). Once a claim has been adequately stated, it may be supported by showing any set of facts consistent with the allegations in the complaint. *Id.* at 1969.

***6** [1] Securities fraud claims are subject to heightened pleading requirements that the plaintiff must meet to survive a motion to dismiss. First, a complaint alleging securities fraud must satisfy Rule 9(b), *Ganino,* 228 F.3d at 168, which requires that " the circumstances constituting fraud ... shall be stated with particularity," Fed.R.Civ.P. 9(b). This pleading constraint serves to provide a defendant with fair notice of a plaintiff's claim, safeguard his reputation from improvident charges of wrongdoing, and protect him against strike suits. *Rombach v. Chang,* 355 F.3d 164, 171 (2d Cir.2004). A securities fraud complaint based on misstatements must (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent. *Novak v. Kasaks,* 216 F.3d 300, 306 (2d Cir.2000). Allegations that are conclusory or unsupported by factual assertions are insufficient. *See Luce v. Edelstein,* 802 F.2d 49, 54 (2d Cir.1986).

[2][3][4] Second, private securities fraud actions must also meet the PSLRA's pleading requirements or face dismissal. *See* 15 U.S.C. § 78u-4(b)(3)(A). In pleading scienter in an action for money damages requiring proof of a particular state of mind, " the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." FN3 *Id.* § 78u-4(b)(2). The plaintiff may satisfy this requirement by alleging facts (1) showing that the defendants had both motive and opportunity to commit the fraud or (2) constituting strong circumstantial evidence of conscious misbehavior or recklessness. *Ganino,* 228 F.3d at 168-69. Moreover, " in determining whether the pleaded facts give rise to a ' strong' inference of scienter, the court must take into account plausible opposing inferences." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* ., ---U.S. - - - - , --- S.Ct. ----, --- L.Ed.2d - - - - , 2007 WL 1773208, at *10 (June 21, 2007). For an inference of scienter to be strong, " a reasonable person [must] deem [it] cogent and *at least as compelling* as any opposing inference one could draw from the facts alleged." *Id.* (emphasis added).

If the plaintiff alleges a false statement or omission, the PSLRA also requires that " the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-4(b)(1).

II. ATSI's Market Manipulation Claims

A. Market Manipulation and Short Selling

[5] Section 10(b), in proscribing the use of a " manipulative or deceptive device or contrivance," *id.* § 78j(b), prohibits not only material misstatements but also manipulative acts. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.,* 511 U.S. 164, 177, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994). Under the statute:

> *7 " Manipulation" is " virtually a term of art when used in connection with securities markets." The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity. Section 10(b)'s general prohibition of practices deemed by the SEC to be " manipulative" -in this technical sense of artificially affecting market activity in order to mislead investors-is fully consistent with the fundamental purpose of the [Exchange] Act " to substitute a philosophy of full disclosure for the philosophy of caveat emptor...."

Sante Fe Indus. v. Green, 430 U.S. 462, 476-77, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977) (alteration in original) (citations omitted). Thus, manipulation " connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst,* 425 U.S. at 199. The critical question then becomes what activity " artificially" affects a security's price in a deceptive manner.

Although not explicitly described as such, case law in this circuit and elsewhere has required a showing that an alleged manipulator engaged in market activity aimed at deceiving investors as to how other market participants have valued a security. The deception arises from the fact that investors are misled to believe " that prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators." *Gurary v. Winehouse,* 190 F.3d 37, 45 (2d Cir .1999); *see also Mobil Corp. v. Marathon Oil Co.,* 669 F.2d 366, 374 (6th Cir.1981) (stating that the Supreme Court has indicated that manipulation under § 10(b) refers to " means unrelated to the natural forces of supply and demand"); *cf. Pagel, Inc. v. SEC,* 803 F.2d 942, 946 (8th Cir.1986) (agreeing with the SEC that " [w]hen individuals occupying a dominant market position engage in a scheme to distort the price of a security for their own benefit, they violate the securities laws by perpetrating a fraud on all public investors"); *Crane Co. v. Westinghouse Air Brake Co.,* 419 F.2d 787, 796 (2d Cir.1969) (holding that nondisclosure of large open market purchases combined with large secret sales to deter stockholders from participating in a competing tender offer violated Rule 10b-5 by " distort[ing] the market picture and deceiv [ing] the [issuer's] stockholders").

In identifying activity that is outside the " natural interplay of supply and demand," courts generally ask whether a transaction sends a false pricing signal to the market. For example, the Seventh Circuit recognizes that one of the fundamental goals of the federal securities laws is " to prevent practices that impair the function of stock markets in enabling people to buy and sell securities at prices that reflect undistorted (though not necessarily accurate) estimates of the underlying economic value of the securities traded," and thus looks to the charged activity's effect on capital market efficiency.[FN4] *See Sullivan & Long, Inc. v. Scattered Corp.,* 47 F.3d 857, 861 (7th Cir.1995). The Seventh Circuit's focus on disruptions to the efficient pricing of a security is consistent with our view that in preventing market rigging, § 10(b) seeks a market where " competing judgments of buyers and sellers as to the fair price of the security brings about a situation where the market price reflects as nearly as possible a just price." *SEC v. First Jersey Sec., Inc.,* 101 F.3d 1450, 1466 (2d Cir.1996) (quoting H.R.Rep. No. 73-1383, at 11 (1934)). In an efficient market, trading engineered to stimulate demand can mislead investors into believing that the market has discovered some positive news and seeks to exploit it, *see In re Initial Pub. Offering Sec. Litig.,* 383 F.Supp.2d 566, 579 (S.D.N.Y.2005), *aff'd Tenney v. Credit Suisse First Boston Corp.,* No. 05-3450-cv, 2006 WL 1423785 (2d Cir. May 19, 2006); the duped investors then transact accordingly. To prevent this deleterious effect on the capital markets, the Third Circuit distinguishes manipulative from legal conduct by asking whether the manipulator " inject[ed] inaccurate information into the marketplace or creat[ed] a false impression of supply and demand for the security ... for the purpose of artificially depressing or inflating the price of the security." *GFL Advantage Fund, Ltd. v. Colkitt,* 272 F.3d 189, 207 (3d Cir.2001); *see also Jones v. Intelli-Check, Inc.,* 274 F.Supp.2d 615, 627-28 (D.N.J.2003).

***8** [6] Market manipulation is forbidden regardless of whether there is a fiduciary relationship between the transaction participants. *See United States v. Russo,* 74 F.3d 1383, 1391-92 (2d Cir.1996); *United States v. Regan,* 937 F.2d 823, 829 (2d Cir.1991). A market manipulation claim, however, cannot be based solely upon misrepresentations or omissions. *Lentell v. Merrill Lynch & Co.,* 396 F.3d 161, 177 (2d Cir.2005). There must be some market activity, such as " wash sales, matched orders, or rigged prices." *See Sante Fe,* 430 U.S. at 476.

[7][8] Furthermore, short selling-even in high volumes-is not, by itself, manipulative. *GFL,* 272 F.3d at 209. Aside from providing market liquidity, short selling enhances pricing efficiency by helping to move the prices of overvalued securities toward their intrinsic values. *See id.* at 208; *Sullivan & Long,* 47 F.3d at 861-62 (discussing the defendants' short sales as arbitrage that eliminates disparities between price and value); *In re Scattered Corp. Sec. Litig.,* 844 F.Supp. 416, 420 (N.D.Ill.1994); John D. Finnerty, Short Selling, Death Spiral Convertibles, and the Profitability of Stock Manipulation 2-3 (Mar.2005), *available at* http://www.sec.gov/rules/petitions/4-500/jdfinnerty050505.pdf; Ralph S. Janvey, *Short Selling,* 20 Sec. Reg. L.J. 270, 272 (1992). In essence, taking a short position is no different than taking a long position. To be actionable as a manipulative act, short selling must be willfully combined with something more to create a false impression of how market participants value a security. Similarly, purchasing a floorless convertible security is not, by itself or when coupled with short selling, inherently manipulative. Such securities provide distressed companies with access to much-needed capital and, so long as their terms are fully disclosed, can provide a transparent hedge against a short sale.

B. Pleading Market Manipulation

[9] Market manipulation requires a plaintiff to allege (1) manipulative acts; (2) damage (3) caused by reliance on an assumption of an efficient market free of manipulation; (4) scienter; (5) in connection with the purchase or sale of securities; (6) furthered by the defendant's use of the mails or any facility of a national securities exchange. *See Schnell v. Conseco, Inc.,* 43 F.Supp.2d 438, 448 (S.D.N.Y.1999); *Cowen & Co. v. Merriam,* 745 F.Supp. 925, 929 (S.D.N.Y.1990).

[10][11] Because a claim for market manipulation is a claim for fraud, it must be pled with particularity under Rule 9(b). *See Internet Law Library, Inc. v. Southridge Capital Mgmt.,* 223 F.Supp.2d 474, 486 (S.D.N.Y.2002); *U.S. Envtl.,* 82 F.Supp.2d at 239; *see also Rooney Pace, Inc. v. Reid,* 605 F.Supp. 158, 162-63 (S.D.N.Y.1985) (applying Rule 9(b) to a market manipulation claim). A claim of manipulation, however, can involve facts solely within the defendant's knowledge; therefore, at the early stages of litigation, the plaintiff need not plead manipulation to the same degree of specificity as a plain misrepresentation claim. *See Internet Law Library,* 223 F.Supp.2d at 486; *U.S. Envtl.,* 82 F.Supp.2d at 240; *cf.*

Romach, 355 F.3d at 175 n. 10 (relaxing the standard where information was likely to be in the exclusive control of the defendants and analysts).

***9** [12] Accordingly, a manipulation complaint must plead with particularity the nature, purpose, and effect of the fraudulent conduct and the roles of the defendants. *See In re Blech Sec. Litig.,* 928 F.Supp. 1279, 1291 (S.D.N.Y.1996) (adopting this test as set forth in the unpublished decision *Baxter v. A.R. Baron & Co. .,* No. 94 Civ. 3913, 1995 WL 600720 (S.D.N.Y. Oct.12, 1995)); *see also Compudyne Corp. v. Shane,* 453 F.Supp.2d 807, 821 (S.D.N.Y.2006); *U.S. Commodity Futures Trading Comm'n v. Bradley,* 408 F.Supp.2d 1214, 1222 (N.D.Okla.2005) (market manipulation under the Commodity Exchange Act); *Fezzani v. Bear, Stearns & Co.,* 384 F.Supp.2d 618, 642 (S.D.N.Y.2004); *In re Royal Ahold N.V. Sec. & ERISA Litig.,* 351 F.Supp.2d 334, 372 (D.Md.2004); *Log On Am., Inc. v. Promethean Asset Mgmt.,* 223 F.Supp.2d 435, 445 (S.D.N.Y.2001); *U.S. Envtl.,* 82 F.Supp.2d at 240; *In re Blech Sec. Litig.,* 961 F.Supp. 569, 580 (S.D.N.Y.1997). *But see Intelli-Check,* 274 F.Supp.2d at 629 (articulating requirements for a less stringent pleading standard in the Third Circuit). General allegations not tied to the defendants or resting upon speculation are insufficient. This test will be satisfied if the complaint sets forth, to the extent possible, " what manipulative acts were performed, which defendants performed them, when the manipulative acts were performed, and what effect the scheme had on the market for the securities at issue." *Baxter,* 1995 WL 600720, at *6; *see also Miller v. Lazard Ltd.,* 473 F.Supp.2d 571, 587 (S.D.N.Y.2007); *In re Sterling Foster & Co. Sec. Litig.,* 222 F.Supp.2d 216, 270 (E.D.N.Y.2002); *Blech,* 961 F.Supp. at 580. This standard meets the goals of Rule 9(b) while also considering which specific facts a plaintiff alleging manipulation can realistically plead at this stage of the litigation.

[13] Because a claim for market manipulation requires a showing of scienter, the PSLRA's heightened standards for pleading scienter also apply. Therefore, the complaint must plead with particularly facts giving rise to a strong inference that the defendant intended to deceive investors by artificially affecting the market price of securities. *See* 15 U.S.C. § 78u-4(b)(2); Section II.A, *supra.* This pleading requirement is particularly important in manipulation claims because in some cases scienter is the only factor that distinguishes legitimate trading from improper manipulation.

C. Manipulation by the Levinson Defendants, Wolfson, and Rose Glen

[14] ATSI's allegations that the Levinson Defendants, Wolfson, and Rose Glen manipulated the market are based on (1) high-volume selling of ATSI's stock with coinciding drops in the stock price, (2) trading patterns around conversion time, (3) the stock's negative reaction to positive news, and (4) the volume of trades in excess of settlement during a 10-day period in 2003. We agree with the district court that these allegations are inadequate under Rule 9(b). In sum, ATSI has offered no specific allegations that the defendants did anything to manipulate the market; it relies, at best, on speculative inferences. Moreover, ATSI has failed to adequately plead scienter.

***10** ATSI's complaint alleges high-volume selling between April 13, 2000 and April 18, 2000, resulting in a 44% decline in stock price. ATSI narrows the list of potential culprits to these defendants because ATSI's major shareholders said that they were not selling stock, leaving only the defendants with large enough blocks of shares to trade at the observed volumes. These allegations fail to state even roughly how many shares the defendants sold, when they sold them, and why those sales caused the precipitous drop in stock price. And the complaint is devoid of facts supporting ATSI's belief that these defendants had sufficient shares to engage in the high-volume trading alleged. Even though the complaint alleges trading volumes of up to 1.5 million shares per day, ATSI reported in its April 14, 2000 Form S-3 that the Shaar Fund held only 492,308 shares of its common stock. The complaint and relevant documents do not reveal how many shares Wolfson and Rose Glen held. ATSI argues that the Shaar Fund's 3,000 shares of Series D Preferred Stock were eventually converted into 8.3 million common shares-sufficient to support the observed trading volumes. This allegation does not help ATSI, however, because the complaint states that the Shaar Fund did not begin converting those preferred shares until December 12, 2000, many months after the high-volume selling.

The complaint then alleges that there was a drop in ATSI's stock price in the days leading up to the defendants' conversion of the Preferred Stock. It alleges that in the absence of manipulation, (1) the Reference Price for conversion should approximate the average price during the 30 days prior to the look-back period and (2) that trading volumes during the look-back periods should have been equal to the average for the previous quarter. We agree with the district court's view that ATSI's " position is ludicrous." *ATSI Commc'ns,* 357 F.Supp.2d at 719. One does not observe constant prices or trading volumes in the stock markets. *Cf. Cent. Nat'l Bank of*

Mattoon v. U.S. Dep't of Treasury, 912 F.2d 897, 902 (7th Cir.1990) (" [T]he value of a company is rarely constant over an entire year ....").

The complaint next alleges that manipulation may be inferred from the stock's negative reaction to positive news. The district court was mistaken in dismissing this circumstance on the grounds that " the announcement concerns events with no apparent connection to the defendants or this case." *ATSI Commc'ns,* 357 F.Supp.2d at 719. The premise of ATSI's theory is that an issuer's stock price, in the absence of manipulation, should increase when good news is announced.[FN5] Under such a theory, the subject of the news and the defendants do not need to be connected.

Nevertheless, this allegation cannot save the complaint because ATSI pleads no particular connection between the negative reaction of the stock price and anything the defendants did. Adopting ATSI's reasoning would subject large holders of convertible preferred stock to the risk of suit under § 10(b) whenever the stock price does not react to news as the issuer expects. *See Rombach,* 355 F.3d at 171 (stating that Rule 9(b) serves, inter alia, to safeguard a defendant's reputation from improvident charges of wrongdoing and protect him against strike suits).

***11** Finally, the complaint rests on an inference of manipulation based upon Depository Trust Company records showing that 8,256,493 shares were traded in excess of settlements during the 10-day period before the AMEX suspended trading of ATSI's stock. Trading volume increased over this period, yet the percentage of trading volume that settled decreased. ATSI claims that the only plausible explanation is that the trades did not result in any change in beneficial ownership, indicating " wash trades, matched trades, phantom shares, and other manipulative trading."

The inference ATSI asks us to draw is too speculative even on a motion to dismiss. *See Segal v. Gordon,* 467 F.2d 602, 606, 608 (2d Cir.1972) (holding that " distorted inferences and speculations" could not meet Rule 9(b)'s requirements). Nowhere does ATSI particularly allege what the defendants did-beyond simply mentioning common types of manipulative activity-or state how this activity affected the market in ATSI's stock. This data could easily be the result of internal settlements within broker-dealers that do not involve the Depository Trust Company. Manipulation is also unlikely given that ATSI's closing share price during this period started at $0.08 per share and ended at $0.08 per share.

[15] For similar reasons, none of these allegations, nor anything else in the complaint, meets the PSLRA's requirements for pleading scienter. *See* 15 U.S.C. § 78u-4(b)(2). A strong inference of scienter is not raised by alleging that a legitimate investment vehicle, such as the convertible preferred stock at issue here, creates an opportunity for profit through manipulation. *See Ganino,* 228 F.3d at 168-69. These circumstances are present for any investor in floorless convertibles. *Cf. Chill v. Gen. Elec. Co.* ., 101 F.3d 263, 267 & n. 5 (2d Cir.1996) (holding that a generalized motive that an issuer wishes to appear profitable, which could be imputed to any public for-profit enterprise, was insufficiently concrete to infer scienter); *In re Alstom SA Sec. Litig.,* 454 F.Supp.2d 187, 197 (S.D.N.Y.2006) (stating a similar proposition for corporate insiders). Accordingly, there is a " plausible nonculpable explanation[ ]" for the defendants' actions that is more likely than any inference that the defendants intended to manipulate the market, *see Tellabs,* --- U.S. ----, at ----, 127 S.Ct. 2499, --- L.Ed.2d ----, at ----, 2007 WL 1773208, at *10: ATSI and the defendants simply entered into mutually beneficial financing transactions. Further, because ATSI has not adequately pled that the defendants engaged in any short sales or other potentially manipulative activity, there is no circumstantial evidence of manipulative intent. *See Ganino,* 228 F.3d at 168-69. Accordingly, more specific allegations are required.

D. Manipulation Claims Against Trimark

[16] The complaint is plainly insufficient in alleging that Trimark engaged in market manipulation.[FN6] It only alleges that Trimark was the principal market maker in ATSI's stock, that Trimark knew or should have known of the manipulation, and that ATSI " believes" that Trimark was a cooperating broker-dealer. Wholly absent are particular facts giving rise to a strong inference that Trimark acted with scienter in manipulating the market in ATSI's common stock and any allegations of specific acts by Trimark to manipulate the market, much less how those actions might have affected the market.

III. ATSI's Misrepresentation Claims

***12** [17] To state a claim under Rule 10b-5 for misrepresentations, a plaintiff must allege that the defendant (1) made misstatements or omissions of material fact, (2) with scienter, (3) in connection with the purchase or sale of securities, (4) upon which the plaintiff relied, and (5) that the plaintiff's reliance was the proximate cause of its injury. *Lentell,* 396 F.3d at 172. The district court properly dismissed the misrepresentations claims.

A. Levinson Defendants and Wolfson

[18][19] Of the misrepresentations that ATSI claims, we can quickly dispose of all except the two alleged in the transaction agreements. The Registration Rights agreement between ATSI and the Shaar Fund plainly states that the only promises, restrictions, and warranties to the transaction were those set forth in the transaction documents. Where the plaintiff is a sophisticated investor and an integrated agreement between the parties does not include the misrepresentation at issue, the plaintiff cannot establish reasonable reliance on that misrepresentation. *See Emergent Capital Inv. Mgmt. v. Stonepath Group, Inc.,* 343 F.3d 189, 196 (2d Cir.2003); *Dresner v. Utility.com, Inc.,* 371 F.Supp.2d 476, 491-93 (S.D.N.Y.2005). By engaging in these private placements of complex securities, ATSI is clearly a sophisticated investor. Accordingly, to the extent ATSI's causes of action are based on alleged misrepresentations made during negotiations preceding the defendants' investment, those claims are barred by the merger clauses.

1. Promise Not to Short Sell

[20][21] The complaint alleges, on information and belief, a fraudulent misrepresentation by the Shaar Fund in promising, in the Securities Purchase Agreement, not to enter a short position prior to closing or cover a short position entered into prior to execution of the agreement using converted common stock. The complaint fails to sufficiently allege that this representation was false when made. While the failure to carry out a promise in connection with a securities transaction might constitute breach of contract, it " does not constitute fraud unless, when the promise was made, the defendant secretly intended not to perform or knew that he could not perform." *Gurary,* 190 F.3d at 44 (internal quotation marks omitted). The speculative allegations that the Levinson Defendants and Wolfson engaged in short selling are deficient for the same reasons that they did not establish manipulation.

[22] ATSI asks us to infer that the Levinson Defendants never intended to honor this promise because they had previously engaged in " death spiral" financing schemes, as evidenced by the declining stock prices of unspecified companies in which they invested. These allegations fail Rule 9(b)'s requirement of stating with particularity why the statement was fraudulent and the PSLRA's requirement of stating the facts on which a belief is based. The complaint does not specify which companies experienced a decline in share price or when they experienced the decline (other than that they occurred within 1 year of an unspecified time of investment). It also fails to allege with particularity what, if anything, the defendants did to cause the decline; it simply offers a generalized allegation that the defendants engaged in death spiral financing combined with a detailed definition of how death spiral financing works. *Cf. United States ex rel. Walsh v. Eastman Kodak Co.,* 98 F.Supp.2d 141, 147 (D.Mass.2000) (holding that fraud was not adequately pled under Rule 9(b) where the plaintiff only alleged a method by which the defendants could produce false invoices without specifying instances of false claims arising from false invoices). Holding otherwise would expose investors in start-ups and risky, distressed companies to fraud claims based solely on the (unsurprisingly) poor performance of their portfolios. *See Rombach,* 355 F.3d at 171.

***13** [23] In response, ATSI argues that it adequately identified the defendants' victims by detailing how the companies could be found by searching the SEC's publicly-available Edgar database. It also contends that the defendants have personal knowledge of what investments they made and when the stock prices of those investments declined.

ATSI cannot sufficiently plead fraud by simply providing a method for the defendant to discover the underlying details. If ATSI had access to the details necessary to make these allegations, it must plead them and not just tell the defendants to go find them.

[24] We also reject ATSI's argument that it adequately pled fraud by pointing to the drop in the stock prices of the defendants' other investments because that information is relevant under Fed.R.Evid. 404(b) and 406 and supports " a reasonable inference of fraud." No inference of sabotage is available from the circumstance that some (or many) risky investments come to nothing. Moreover, the allegations fail to point to any specific actions by the defendants with respect to those investments and thus fail to establish that the defendants' promise was fraudulent. To the extent the Southern District of New York's decision in *Internet Law Library,* 223 F.Supp.2d 474, is to the contrary, we reject it.

2. Investor Profile Representation

[25][26] ATSI also claims that the representation in the Securities Purchase Agreement that the Shaar Fund was an accredited investor was fraudulent. The complaint does not sufficiently allege loss causation with respect to this misrepresentation. A plaintiff is required to prove both

transaction causation (also known as reliance) and loss causation. Lentell, 396 F.3d at 172; *see also* 15 U.S.C. § 78u-4(b)(4). Transaction causation only requires allegations that " but for the claimed misrepresentations or omissions, the plaintiff would not have entered into the detrimental securities transaction." Lentell, 396 F.3d at 172 (quoting *Emergent Capital,* 343 F.3d at 197). Loss causation, by contrast, is the proximate causal link between the alleged misconduct and the plaintiff's economic harm. *See* *Dura Pharm., Inc. v. Broudo,* 544 U.S. 336, 346, 125 S.Ct. 1627, 161 L.Ed.2d 577 (2005); *Lentell,* 396 F.3d at 172. To that end, the plaintiff's complaint must plead that the loss was foreseeable and caused by the materialization of the risk concealed by the fraudulent statement. *See* Lentell, 396 F.3d at 173.

The complaint alleges losses (1) through the tremendous decline in ATSI's share price, impairing its access to capital and its viability as a business; and (2) by ATSI's sale of its own stock at depressed prices. It fails, however, to establish any causal connection between those losses and the misrepresentation that the Shaar Fund was an accredited investor. In what appears to be an attempt to meet *Lentell's* requirements, ATSI contends that it adequately pled loss causation because the Levinson Defendants made this misrepresentation to induce ATSI to enter into the transaction under the pretense that they were " trustworthy, reputable and long-term investor[s]," and that when the true risk of their plans materialized through their manipulative acts, ATSI suffered losses. This allegation might support transaction causation; it fails, however, to show how the fact that the Shaar Fund was not an accredited investor caused any loss. *See id.* at 174 (" Such an allegation-which is nothing more than a paraphrased allegation of transaction causation-explains why a particular investment was made, but does not speak to the relationship between the fraud and the loss of the investment." (internal quotation marks omitted)).

***14** ATSI is wrong in claiming that these allegations are sufficient to establish loss causation under our decision in *Weiss v. Wittcoff,* 966 F.2d 109 (2d Cir.1992) (per curiam). In *Weiss,* the plaintiff agreed to merge his business with the defendant's on the latter's representation that his other company would supply goods and services. *Id.* at 110. When the defendant sold his other company a year after the transaction, *id.* at 110, 112, the plaintiff's business suffered subsequent losses from higher costs, *id.* at 110-11. We held that the complaint adequately pled loss causation because the plaintiff's losses were " clearly a proximate result of his reliance on defendants' promises, since defendants' failure to fulfill those promises foreseeably caused [the business's] financial condition to deteriorate." *Id.* at 111.

Weiss is easily distinguishable. There, the complaint established a causal connection between (1) the promise to provide for the business's needs and (2) the business's increased costs when the promise turned out to be false. *See id.* ATSI, by contrast, fails to show that the subject of the fraudulent statement proximately caused any loss. *See* *Lentell,* 396 F.3d at 173 (" Thus to establish loss causation, ' a plaintiff must allege ... that the *subject* of the fraudulent statement or omission was the cause of the actual loss suffered ....' " (alteration in original)).

B. Misrepresentations by Rose Glen

The misrepresentations attributed to Rose Glen suffer from largely the same defects as those against the Levinson Defendants. ATSI cannot claim reliance on Rose Glen's pre-contractual, verbal representations because of the merger clause in the Registration Rights Agreement.

The only representation in the Securities Purchase Agreement that merits discussion is the one in which Rose Glen represented that it was purchasing the Preferred Stock:

for its own account and not with a present view towards the public sale or distribution thereof except pursuant to sales registered or exempted from registration under the 1933 Act; *provided, however* that by making the representation herein, the Buyer does not agree to hold any of the Securities for any minimum or other specific term and reserves the right to dispose of the Securities at any time in accordance with or pursuant to a registration statement or an exemption under the 1933 Act.

In addition to failing to plead falsity under *Gurary,* ATSI's complaint fails to plead that Rose Glen even broke this promise, much less that it secretly intended to break it.

[27][28] ATSI also alleges that Rose Glen engaged in a bait-and-switch scheme by first promising in its draft term sheet to invest $10 million, then offering only $2.5 million at closing. The district court properly dismissed this claim. First, it is time-barred. Prior to the passage of the Sarbanes-Oxley Act of 2002, Pub.L. No. 107-204, 116 Stat. 745 (2002), the statute of limitations required that a Rule 10b-5 claim be brought within one year of discovery of the facts constituting the violation and within three years of the violation. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson,* 501 U.S. 350, 364, 111 S.Ct. 2773, 115 L.Ed.2d 321 (1991). ATSI learned of the

alleged falsity of this representation when it signed the closing documents on October 16, 2000, but did not commence its action against Rose Glen until October 31, 2002-more than two years later. *See* LC Capital Partners, LP v. Frontier Ins. Group, Inc., 318 F.3d 148, 154 (2d Cir.2003) (stating that the limitations period begins to run, inter alia, after the plaintiff receives actual knowledge of the facts giving rise to the action). Second, ATSI has not pled falsity or reliance because the term sheet expressly stated that Rose Glen's " obligation to fund is subject to satisfactory due diligence, in RGC's sole discretion."

C. Misrepresentations by CCM

***15** ATSI claims that CCM made misrepresentations very similar to those alleged against Rose Glen. Largely for the same reasons as above, the district court properly dismissed those claims.

IV. Control Person Liability

[29] ATSI alleges control person liability under § 20(a) against the Levinson Defendants, Wolfson, Rose Glen, and the Citco Defendants. To establish a prima facie case of control person liability, a plaintiff must show (1) a primary violation by the controlled person, (2) control of the primary violator by the defendant, and (3) that the defendant was, in some meaningful sense, a culpable participant in the controlled person's fraud. *First Jersey,* 101 F.3d at 1472. ATSI fails to allege any primary violation; thus, it cannot establish control person liability.

V. Leave to Amend

[30][31] ATSI argues that even if the district court properly dismissed its complaints under Fed.R.Civ.P. 12(b)(6), it should have granted leave to amend. We review a district court's denial of leave to amend for abuse of discretion. *Grace v. Rosenstock,* 228 F.3d 40, 54 (2d Cir.2000). In *ATSI I,* ATSI submitted three amended complaints; in *ATSI II,* it submitted a complaint largely identical to *ATSI I's* third amended complaint. The district court had already dismissed *ATSI I's* first amended complaint for failure to meet Rule 9(b) and the PSLRA's pleading requirements on many grounds similar to its final dismissal. District courts typically grant plaintiffs at least one opportunity to plead fraud with greater specificity when they dismiss under Rule 9(b). *See Luce,* 802 F.2d at 56. ATSI was given that opportunity. The district court did not abuse its discretion in declining to grant further leave to amend.

CONCLUSION

For the foregoing reasons, the judgments of the district court are AFFIRMED.

FN1. An investor sells short when he sells a security that he does not own by borrowing the security, typically from a broker. *See Levitin v. PaineWebber, Inc.,* 159 F.3d 698, 700 (2d Cir.1998). At a later date, he " covers" his short position by purchasing the security and returning it to the lender. *Id.* A short seller speculates that the price of the security will drop. *Id.* If the price drops, the investor profits by covering for less than the short sale price. *Id.* If, on the other hand, the price increases, the investor takes a loss. A short seller's potential losses are limitless because there is no ceiling on how high the stock price may rise.

FN2. We have declined to read *Twombly's* flexible " plausibility standard" as relating only to antitrust cases. *See Iqbal v. Hasty,* ---F.3d ----, 2007 WL 1717803, at *11 (2d Cir. June 14, 2007). " Some of [*Twombly's*] language relating generally to Rule 8 pleading standards seems to be so integral to the rationale of the Court's parallel conduct holding as to constitute a necessary part of that holding." *Id.*

FN3. In a Rule 10b-5 action, scienter requires a showing of " intent to deceive, manipulate, or defraud," *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 194 n. 12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), or reckless conduct, *In re Carter-Wallace, Inc. Sec. Litig.,* 220 F.3d 36, 39 (2d Cir.2000); *SEC v. U.S. Envtl., Inc.,* 155 F.3d 107, 111 (2d Cir.1998) (stating in dicta that reckless behavior is sufficient to plead scienter).

FN4. The efficient capital market hypothesis, as adopted by the Supreme Court, posits that " the market price of shares traded on well-developed markets reflects all publicly available information." *See Basic Inc. v. Levinson,* 485 U.S. 224, 246 & n. 24, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988).

FN5. The strength of this broad proposition is questionable. *Cf. United States v. Bilzerian,* 926 F.2d 1285, 1298 (2d Cir.1991) (" [W]hether a public company's stock price moves up or down or stays the same after the filing of a Schedule 13D does not establish the materiality of the statements made, though stock movement is a factor the jury may consider relevant."). For example, the stock price may not move if the market already knew about the good news, or if the market believes the news is overblown or false, or if adverse developments in the company or industry are anticipated or rumored.

FN6. Rose Glen and Trimark also argue that ATSI lacks standing to bring a Rule 10b-5 claim against them because ATSI sold its Preferred Stock and warrants to the defendants in primary market transactions and did not transact in the allegedly manipulated secondary market. Because ATSI's complaints do not meet the pleading requirements, we choose not to reach this statutory standing question. *See* *Coan v. Kaufman,* 457 F.3d 250, 256 (2d Cir.2006) (" Unlike Article III standing, which ordinarily should be determined before reaching the merits, statutory standing may be assumed for the purposes of deciding whether the plaintiff otherwise has a viable cause of action." (citations omitted)); *see also* *Official Comm. Of Unsecured Creditors of Worldcom, Inc. v. SEC,* 467 F.3d 73, 80-81 (2d Cir.2006); *cf.* *Steel Co. v. Citizens for a Better Env't,* 523 U.S. 83, 97 n. 2, 118 S.Ct. 1003, 140 L.Ed.2d 210 (1998).

C.A.2 (N.Y.),2007.
ATSI Communications, Inc. v. Shaar Fund, Ltd.
--- F.3d ----, 2007 WL 1989336 (C.A.2 (N.Y.))

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Levine v. Philip Morris Inc.
N.Y.Sup.,2004.
(The decision of the Court is referenced in a table in the New York Supplement.)

Supreme Court, New York County, New York.
Susan LEVINE as the Administratrix of the Estate of Deena Soloway, Plaintiff,
v.
PHILIP MORRIS INCORPORATED, Defendant.
No. 102765/1998.

Sept. 22, 2004.

CHARLES EDWARD RAMOS, J.

***1** Defendant moves, pursuant to CPLR 3212, for summary judgment dismissing the complaint.

Background

Deena Soloway commenced this action on or about February 13, 1998. Soloway was born in 1969, and allegedly began smoking cigarettes in 1982, when she was 13 years old. She allegedly smoked Marlboro Lights, a brand of cigarettes manufactured and sold by defendant Philip Morris Incorporated. Soloway continued to smoke until some time before May 14, 1996, when she was diagnosed with lung cancer. The cancer spread to Soloway's brain and kidneys, and she died on February 26, 1998, when she was 28 years old. Her mother, Susan Levine, was thereafter substituted as plaintiff, in her capacity as administratrix of Soloway's estate.

The complaint asserts four causes of action. The first cause of action, for negligence, alleges that defendant failed to exercise reasonable care in the design, manufacture, marketing, and distribution of Marlboro Lights, because defendant: designed and manufactured Marlboro Lights so that they were carcinogenic, addictive, and unreasonably dangerous; targeted minors, like Soloway, with its marketing and advertising for Marlboro Lights, despite the fact that the laws of New York State prohibit the sale of tobacco products to minors; and failed to take reasonable steps, in its design, manufacture, marketing, and distribution of Marlboro Lights cigarettes, to minimize the risk that they would be used by minors.

The second cause of action, for strict product liability, alleges that Marlboro Lights cigarettes were " defective and not reasonably safe for the uses for which they were intended, [although] it was feasible to design those products in a safer manner" (Complaint, ¶ II:6).

The third cause of action, for breach of the implied warranty of merchantability, alleges that defendant impliedly warranted to consumers that its Marlboro Lights cigarettes " were merchantable and fit for the ordinary purposes for which they were used," but that that warranty was " false and untrue, in that the tobacco products ... were unsafe for human consumption because they contained addictive and carcinogenic properties of an unreasonably dangerous nature" (*id.*, ¶¶ III:8-9).

The fourth cause of action alleges that defendant violated General Business Law § 349, because, as a result of its youth-targeted marketing and distribution practices, defendant " induced and facilitated the continued unlawful use of its tobacco products by children [like Soloway], and thereby has engaged and continues to engage in deceptive acts and practices" (*id.*, IV:10).

Negligence, Strict Liability, and Breach of Warranty Claims

Plaintiff's negligence, strict product liability, and breach of implied warranty claims are barred by California's one-year statute of limitations for those claims, which is made applicable by CPLR 202, New York's " borrowing statute." CPLR 202 requires the dismissal of a cause of action which is brought by a non-New York resident, and based upon a cause of action which accrued in a jurisdiction other than New York, if the action is untimely under the statute of limitations of either New York or the other jurisdiction (*see* *Dugan v. Schering Corp.,* 86 N.Y.2d 857, 859 [1995]).

***2** The complaint's first three claims accrued in California, at a time when Soloway was a resident of that state. In tort cases, and for purposes of the borrowing statute, New York has " consistently employed the traditional definition of accrual-a cause of action accrues at the time and in the place of the injury" (*Global Fin. Corp. v. Triarc Corp.*, 93 N.Y.2d 525, 529 [1999]).

Pursuant to CPLR 214-c (2), the limitations period: within which an action to recover damages for personal injury ... caused by the latent effects of exposure to any substance or combination of substances ... upon or within the body ... must be commenced shall be computed from the date of discovery of the injury by the plaintiff or from the date when through the exercise of reasonable diligence such injury should have been discovered by the plaintiff, whichever is earlier.

As used in the statute, the term " injury" means " an actual illness, physical condition or other similarly discoverable objective manifestation of the damage caused by previous exposure to an injurious substance" (*Sweeney v. General Printing, Inc.*, 210 A.D.2d 865, 865-866 [3d Dept 1994]). " Discovery of the injury" means " discovery of the physical condition [upon which a plaintiff's claim is based] and not ... the more complex concept of discovery of both the condition and the nonorganic etiology of that condition" (*Matter of New York County DES Litig.*, 89 N.Y.2d 506, 514 [1997]).

Thus, accrual occurs upon manifestation of the symptoms of the condition which is the basis of the claim, and not upon formal conclusive diagnosis of that condition (*see Neri v. R.J. Reynolds Tobacco Co.*, 185 F Supp 2d 176, 179-181 [ND N.Y.2001]; *Matter of New York County DES Litig.*, 89 N.Y.2d at 515 [rejecting an interpretation of CPLR 214-c (2) which would make accrual dependent upon " such fortuitous circumstances as the medical sophistication of the individual plaintiff and the diagnostic acuity of his or her chosen physician"]; *Pearl v. Eli Lilly & Co.*, 262 A.D.2d 106, 106 [1st Dept 1999], appeal denied, 94 N.Y.2d 752 [1999]; *Harley v. 135 East 83rd Owners Corp.*, 238 A.D.2d 136, 136-138 [1st Dept 1997]).

Under the foregoing principles, and plaintiff's assertions to the contrary notwithstanding, plaintiff's first three causes of action accrued in California. Soloway moved to California in late 1992 or 1993, and worked and resided there until approximately mid-1996. She visited doctors in California on several occasions, beginning in the spring of 1995, with complaints of coughing, chest pain, and other respiratory symptoms. A CT scan was taken of her chest on March 21, 1996, in Los Angeles. According to the radiologist's report, the CT scan revealed " [a]n irregular mass measuring approximately 3-3.9 cm .... in the right lower lobe" of Soloway's lung, which was " suspicious for malignancy" (Quigley Reply Affirm., Ex. R, Medical Record [MR] 254402-00001).

***3** A " fine needle aspiration" biopsy was taken of the mass, on March 27 or 28, 1996, also in Los Angeles, but the results were " inconclusive" as to whether the mass was malignant (*id.*, Ex. U, MR 254405-00020). On April 16, 1996, another doctor in Los Angeles noted that Soloway had " a persistent [right lower lobe] mass" which had " been present for at least 7 months" (*id.*, Ex. V, MR 254405-00034). According to the doctor's notes, he " told her [that he] did not think [the mass] was malignant but [that] there was a 10-20% chance," and that, " no matter what it is, it ... should be removed". (*id.*). Soloway had surgery to remove the mass in New York, on May 14, 1996, and, based upon post-operative tests, was diagnosed as having cancer (Fiano Affirm., ¶¶ 77-78 and Ex. 74, MR 254341-00009).

Although Soloway was not definitively diagnosed as having lung cancer until after she had surgery in New York, California is the place where she first experienced the various respiratory symptoms of that condition, and where doctors discovered the mass in her lung, which the radiologist found to be " suspicious for malignancy," which another doctor reportedly advised her had a " 10-20% chance" of being malignant, and which did eventually prove to be malignant. Thus, the complaint's first three causes of action accrued in California.

Plaintiff contends that the claims did not accrue until she was conclusively diagnosed with lung cancer, in New York. According to plaintiff, Soloway had ambulatory pneumonia for a period of approximately one year prior to the diagnosis of lung cancer, and her symptoms of coughing and chest pain were not clearly attributable to lung cancer rather than to pneumonia. Thus, according to plaintiff, Soloway's respiratory symptoms were not alone sufficient to make her aware of " the primary condition" which is the basis of the complaint's first three causes of action (*Matter of New York County DES Litig.*, 89 N.Y.2d at 509, 514 n 4).

However, the medical records do not indicate that Soloway had pneumonia continually during the entire year or so prior to the diagnosis of lung cancer, but only that she had pneumonia for some discrete period of time (*see* Fiano Affirm., Exs. 71, 72). Because Soloway's respiratory symptoms evidently persisted after she no longer had pneumonia, it was presumably clear that the symptoms did not relate exclusively to pneumonia. Nor, in any event, does plaintiff assert that the mass in Soloway's lung could have been reasonably misapprehended as a symptom of pneumonia.

Defendant has also adequately established that Soloway was a resident of California at the time when the complaint's first three claims accrued. " [T]he determination of whether a plaintiff is a New York resident, for purposes of CPLR 202, turns on whether he has a significant connection with some locality in the State as the result of living there for some length of time during the course of a year" (*Antone v. General Motors Corp.*, 64 N.Y.2d 20, 30 [1984]).

***4** Plaintiff concedes that Soloway resided in California from late 1992 or 1993 until mid-1996 (*see* Fiano Affirm., ¶ 75; Pl. Resp. to Interrogs., Quigley Affirm., Ex. B, ¶ 3). During that time, she was employed in that state, obtained a California state driver's license, and paid California state income taxes for the years 1993 through 1996 (*see* Quigley Affirm., ¶¶ 10-12 and Exs. B ¶ 21; E). During that same period, on various occasions, Soloway allegedly visited and stayed at her mother's or sister's residence in New York, and also visited a doctor in New York. However, those occasional visits do not establish the requisite " significant connection with some locality in [New York State] as the result of living there for some length of time during the course of a year."

Accordingly, at the time when the symptoms of Soloway's lung cancer manifested themselves, and the complaint's first three causes of action accrued, she was a resident of California rather than New York. That finding is not altered by the facts that Soloway subsequently returned to New York on a temporary basis, in May 1996, for the surgery to remove the mass from her lung, and on a permanent basis, in September or October 1996 (*see Dugan v. Schering Corp.*, 86 N.Y.2d at 859 [determining residency, for purposes of CPLR 202, " at the time the cause of action accrued"]).

Because Soloway's claims accrued in California, at a time when she was a resident of California, the claims are barred by CPLR 202 if they are untimely under the limitations period applicable to those claims under California law. Plaintiff does not dispute defendant's contention that, if CPLR 202 is applicable, then the complaint's first three causes of action are subject to a one-year limitations period, and are untimely, under applicable California law.

Section 340 (3) of the California Code of Civil Procedure (CCCP), which was generally applicable to causes of action filed prior to January 2003, established a one-year statute of limitations for actions based upon " injury to or for the death of one caused by the wrongful act or neglect of another." FN1 Under California law, that one-year limitations period would apply to plaintiff's claims based upon the theories of negligence, strict product liability, and breach of implied warranty (*see e.g. Goldrich v. Natural Y Surgical Specialities, Inc.*, 25 Cal App 4th 772, 778-779, 31 Cal Rptr 2d 162, 166 [Cal Ct App, 2d Dist 1994] [negligence, product liability, and breach of implied warranty claims], Review denied, 1994 Cal Lexis 4590 [Cal 1994]; *Rose v. Fife*, 207 Cal App 3d 760, 770-772, 255 Cal Rptr 440, 446-448 [Cal Ct App, 2d Dist 1989] [product liability and breach of implied warranty claims]).

FN1. The statute was amended, effective January 1, 2003, to allow for a two-year limitations period (*see* CCCP § 335.1). However, the amendment applies retroactively only to claims arising out of the September 11, 2001 terrorist attacks, and, therefore, is not relevant to the claims in this action (*see Krupnick v. Duke Energy Morro Bay, L.L.C.*, 115 Cal App 4th 1026, 1028-1030, 9 Cal Rptr 3d 767, 768-770 [Cal Ct App, 2d Dist 2004], Review denied, 2004 Cal Lexis 4144 [Cal 2004]).

In determining whether the complaint's first three claims are timely under California law, the court must consider not only the length of the limitations period, but also California's rules governing accrual of the claims (*see Saylor v. Lindsley*, 302 F Supp 1174, 1180 [SD N.Y.1969]). The California Supreme Court has held that, in latent injury cases, the statute begins to run when a plaintiff suspects, or should reasonably suspect, that his or her injury was caused by wrongdoing (*see Jolly v. Eli Lilly & Co*, 44 Cal 3d 1103, 1110, 751 P.2d 923, 927 [Cal 1988]; *see also Soliman v.. Philip Morris Inc.*, 311 F3d 966, 972

[9th Cir2002] [applying California law, and holding that statute of limitations began to run when plaintiff " should first have suspected that defendants' tobacco products had injured him, whether or not he knew of defendants' wrongful conduct"], *cert denied* 540 U.S. 814, 124 S Ct 64 [2003]). However, even if the one-year limitations period applicable to the complaint's first three causes of action under California law were deemed to have begun only when Soloway was conclusively diagnosed with cancer (i.e., on or about May 14, 1996), it would still have expired before this action was commenced (i.e., when the complaint was filed on or about February 13, 1998). Thus, because plaintiff's first three causes of action would be untimely under the limitations period and accrual principles applicable to them under California law, those claims are dismissed.

General Business Law § 349 Claim

***5** Defendant argues that plaintiff's cause of action under GBL § 349 is precluded by California Civil Code (CCC) § 1714.45, a statute which bars certain claims against manufacturers and sellers of tobacco products, based upon their conduct during the 10-year period extending from January 1, 1988 through December 31, 1997.[FN2] According to defendant, New York's choice of law principles mandate that the parties' dispute be governed by California substantive law. However, assuming that there is a conflict between the laws of California and New York with regard to plaintiff's GBL § 349 claim,[FN3] defendant has failed to bear its burden of establishing that the law of California should govern the disposition of that claim (*see Allstate Ins. Co. v. Conigliaro,* 248 A.D.2d 293, 294 [1st Dept 1998]; *Reale by Reale v. Herco, Inc.,* 183 A.D.2d 163, 167 [2d Dept 1992]).

FN2. Before the statute was amended, effective January 1, 1998, CCC § 1714.45(a) provided, in relevant part, that a manufacturer or seller shall not be liable in " a product liability action" if: (1) The product is inherently unsafe and the product is known to be unsafe by the ordinary consumer who consumes the product with the ordinary knowledge common to the community; and (2) The product is a common consumer product intended for personal consumption, such as sugar, castor oil, alcohol, tobacco, and butter, as identified in comment i to Section 402A of the Restatement (Second) of Torts.

FN3. *See Matter of Allstate Ins. Co. (Stolarz),* 81 N.Y.2d 219, 223 [1993] [noting that " (t)he first step in any case presenting a potential choice of law issue is to determine whether there is an actual conflict between the laws of the jurisdictions involved"]).

When conflicting laws are potentially applicable, New York employs " an interest analysis rule that gives effect to the law of the jurisdiction having the greatest interest in resolving the particular issue involved. An evaluation of the facts or contacts which ... relate to the purpose of the particular law in conflict determines the greater interest" (*Elson v. Defren,* 283 A.D.2d 109, 115 [1st Dept 2001] [citations and internal quotation marks omitted]). " In weighing the various interests, New York courts distinguish between ' conduct regulating' and ' loss allocating' rules" (*id.*).

Here, both conduct regulating and loss allocating rules are in issue. GBL § 349 is a conduct regulating rule, because it has " the prophylactic effect of governing conduct to prevent injuries from occurring" (*Padula v. Lilarn Props. Corp.,* 84 N.Y.2d 519, 522 [1994]), i.e., by proscribing " deceptive acts and practices ... by merchants, service providers, and manufacturers that will adversely affect consumers and others" (*Bergeron v. Philip Morris, Inc.,* 100 F Supp 2d 164, 169-170 [ED N.Y.2000] [characterizing GBL § 349 as a conduct regulating rule]). By contrast, CCC § 1714.45 is a loss allocating rule, because, with respect to the period of its effectiveness, it seeks to " prohibit, assign, or limit liability after [a] tort [has already] occur[red]" (*Padula v. Lilarn Props. Corp.,* 84 N.Y.2d at 522).

However, regardless of whether the choice of law analysis appropriate to conduct regulating or loss allocating rules is applied, such analysis indicates that New York law should govern the disposition of plaintiff's GBL § 349 claim. " If conduct regulating rules conflict, New York courts usually apply the law of the place where the tort occurred because that jurisdiction has the greatest interest in regulating behavior that takes place within its borders" (*Elson v. Defren,* 283 A.D.2d at 115). Plaintiff's GBL § 349 claim is predicated upon conduct which allegedly occurred within New York State. The complaint alleges that defendant violated GBL § 349, by means of its " youth-targeted marketing, promotional and distribution practices," which " induced and facilitated the ... unlawful use of its tobacco products by children such as [Soloway]," and that Soloway " was, in fact, induced by the aforesaid deceptive acts and practices ... and in approximately 1982 began smoking Marlboro Lights, to which she became addicted and continued to smoke until shortly before she was diagnosed with lung cancer" (Complaint, ¶¶ IV:10-11). Thus, the allegedly deceptive acts and practices purportedly induced Soloway to begin smoking in 1982, while she resided in New York, and New York has the greatest interest in regulating the conduct that allegedly took place within its borders.

***6** " If loss allocating rules conflict, the three so-called *Neumeier* rules adopted in *Neumeier v. Kuehner* [31 N.Y.2d 121 (1972)] govern the choice of law analysis" (*Elson v. Defren,* 283 A.D.2d at 115). " Under the first *Neumeier* rule, where ... the parties to the lawsuit share a common domicile, the loss allocation rule of the common domicile will apply" (*id.* [citation and internal quotation marks omitted]).

For purposes of choice of law analysis, and with particular regard to the question of which state's law shall govern plaintiff's GBL § 349 claim, the court finds that Soloway and defendant shared the common domicile of New York. Although Philip Morris is a Virginia corporation, it maintains its principal place of business in New York, and is therefore considered a New York domiciliary for choice of law purposes (*see Elson v. Defren,* 283 A.D.2d at 116; *see also Bergeron v. Philip Morris, Inc.,* 100 F Supp 2d at 170). Soloway was a domiciliary of California from approximately 1993 through approximately mid-1996, the period during which she began to experience the symptoms of her lung cancer. However, she was apparently domiciled in New York from approximately mid or late 1996 through the time of her death in February 1998, during which time she commenced this action by filing the complaint.

For choice of law purposes, generally, a party's domicile will be determined as of the time when the tort occurred, and a post-tort change in domicile is irrelevant (*see Wheeler v. Standard Tool and Mfg. Co.,* 359 F Supp 298, 301 [SD N.Y.1973], *affd* 497 F.2d 897 [2d Cir1974]; *Schultz v. Boy Scouts of Am., Inc.,* 65 N.Y.2d 189, 194 [1985]). However, a party's post-tort change in domicile has been recognized, for choice of law purposes, where, as in the present case, the party's domicile was changed to New York, the forum was New York, and the other party's domicile was New York (*see Schultz v. Boy Scouts of Am., Inc.,* 65 N.Y.2d at 194 [citing *Miller v. Miller,* 22 N.Y.2d 12, 22 (1968)]).

Defendant has failed to articulate any adequate reason to ignore Soloway's post-tort change in domicile to New York, or to deny the application of New York law to plaintiff's GBL § 349 claim, under the particular circumstances of this case. Defendant does not contend, for example: that either defendant or Soloway patterned their conduct, or relied upon, the law of California; that Soloway's post-tort change in domicile to New York was motivated by the desire to achieve a more favorable legal climate, or otherwise implicates policies against forum shopping; or that California has any particular interest in barring a remedy for injuries allegedly sustained by Soloway as a result of defendant's purportedly deceptive conduct, which occurred in New York, in and prior to 1982 (*see generally Miller v. Miller,* 22 N.Y.2d at 19-22). It is New York, rather than California, which has the more significant relationship with the issues involved in plaintiff's GBL § 349 claim, and which has the more significant interest in the application of its law to those issues (*see id.,* 22 N.Y.2d at 22).

***7** GBL § 349 prohibits deceptive acts and practices in the conduct of business, trade, and commerce.

A deceptive act or practice is not the mere invention of a scheme or marketing strategy, but the actual misrepresentation or omission to a consumer, by which the consumer is caused actual, although not necessarily pecuniary, harm. Thus, to prevail in a cause of action under GBL [§ 349] ..., the plaintiff must prove that the defendant made misrepresentations or omissions that were likely to mislead a reasonable consumer in the plaintiff's circumstances, that the plaintiff was deceived by those misrepresentations or omissions and that as a result the plaintiff suffered injury.

(*Solomon v. Bell Atl. Corp.,* --- A.D.2d ----, 777 N.Y.S.2d 50, 55 {9 AD3d 49} [1st Dept 2004] [citations and internal quotation marks omitted]). Accordingly, plaintiff must offer evidence that defendant made a misrepresentation or omission which was likely to mislead a reasonable consumer, which actually deceived Soloway, and which caused her injury.

In opposition to defendant's motion, plaintiff asserts that defendant engaged in two types of deceptive acts or practices which are the basis of plaintiff's GBL § 349 claim. First, plaintiff alleges that defendant engaged in deceptive youth-targeted marketing and promotional practices which induced Soloway and other minors to begin and to continue smoking. Plaintiff alleges that those practices were deceptive, in that defendant knew that the sale of tobacco products to minors was illegal, and that minors lacked the capacity and maturity to understand the true risks associated with cigarette smoking.

In support of the foregoing allegations, plaintiff has offered deposition testimony and documentary evidence to the effect that: (1) defendant knew that its " Marlboro Country" advertising and promotion campaign, with its " open West country" scenes and the " Marlboro Man," was particularly appealing to minors; (2) largely because of that appeal, Marlboro dominated the market of youthful smokers, prior to, and at the time when, Soloway began to smoke; (3)during the relevant time period, Marlboro Lights were marketed under the Marlboro Country campaign; (4) Soloway was fascinated by photographs of film actors smoking unidentified brands of cigarettes, and found such photographs to be visually appealing; (5) Soloway had a strong interest in advertising, even when she was a child, and the Marlboro Country advertisements were her favorite advertisements; and (6) Soloway began smoking Marlboro Lights, when she was a minor, because she saw that brand promoted in advertisements that she liked.

As reprehensible as encouraging children to smoke is, it is not in and of itself deceptive. In fact, until the Master Settlement Agreement was executed, advertising to children to smoke, even though it would be illegal. for them to purchase cigarettes, Penal Law § 260.20 [FN4] and § 260.21, was not illegal. MSA Section III. Even taking into consideration plaintiff's youth in determining whether she was misled by the advertisements and acted reasonably in deciding to smoke, the result is the same. (*Dunn v. Northgate Ford,* 2004 N.Y. Slip Op 50030U *3 [Sup Ct, Broome County 2004]).

FN4. Penal Law § 260.20, enacted in 1965, was amended in 1992

***8** The mere fact that Soloway may have seen and liked Marlboro cigarette advertisements, and found them to be visually pleasing or appealing, even at a time when she was herself too young to smoke legally, or that those advertisements may have appealed to minors more generally, does not itself render those advertisements deceptive. Nor has plaintiff offered any evidence that Soloway was actually deceived, or that she ever claimed to have been deceived, by any of defendant's advertising or promotions. Finally, in view of the foregoing facts, plaintiff has also failed to offer any evidence that Soloway suffered an injury which was the result of her having been deceived by a misrepresentation or omission made by defendant.[FN5]

FN5. Plaintiff argues that the element of reliance is present, with respect to the complaint's GBL § 349 claim, and defendant argues that plaintiff's inability to show the element of reliance warrants dismissal of plaintiff's GBL § 349 claim. However, whether or not plaintiff can demonstrate the element of reliance is irrelevant, because, although a plaintiff " must show that the defendant's material deceptive act caused the [plaintiff's] injury," " reliance is *not* an element of a section 349 claim" (*Stutman v. Chemical Bank,* 95 N.Y.2d 24, 29 [2000] [citation and internal quotation marks omitted]).

Indeed, any determination that Soloway began or continued smoking because of defendant's advertising would be purely speculative, in light of the evidence contained in the record that Soloway may have begun and continued to smoke for various reasons apart from defendant's advertising, e.g., because she found pictures of actors smoking cigarettes to be aesthetically beautiful, without regard to the brand of the cigarettes involved (*see* D. Moody EBT, at 130-132); because she perceived that virtually everyone around her smoked, including her mother, her father, her step-mother, her older sister, and " all" of her friends (*see* S. Levine EBT, at 154, 208, 210; H. Soloway EBT, at 52-54, 72; R. Soloway EBT, at 45; F. Levine EBT, at 131, 134); because it made her feel good, or important, or glamorous (*see* S. Levine EBT, at 206, 207, 210, 218); because she enjoyed it (*see* S. Levine EBT, at 234; R. Soloway EBT, at 110; F. Levine EBT, at 144); and because it helped her to relax, and relieved stress (*see* S. Levine EBT, at 116, 117).

For the foregoing reasons, plaintiff has failed to raise an issue of fact as to whether defendant's purportedly youth-targeted advertising contained any misrepresentation or omission which was likely to mislead a reasonable consumer, which did actually deceive Soloway, and which caused injury to Soloway.

As a second basis for the complaint's GBL § 349 claim, plaintiff alleges that defendant's use of the terms " low tar," " light," and/or " lights" in advertisements for Marlboro Lights cigarettes was deceptive. According to plaintiff, those terms implied that Marlboro Lights delivered less tar and/or nicotine to the smoker, and were safer or healthier than other cigarettes, whereas defendant knew, from its own internal research, that Marlboro Lights cigarettes delivered at least as much tar and nicotine as other cigarettes.

Plaintiff's allegation as to the deceptiveness of defendant's use of the terms " low tar," " light," and " lights" is not set forth in the complaint, but is raised for the first time in plaintiff's papers in opposition to defendant's motion. In any event, that allegation fails to provide a viable basis for plaintiff's GBL § 349 claim. Even assuming, arguendo, that defendant's use of the subject terminology was deceptive as a general matter, there is no evidence in the record that Soloway was actually deceived by that terminology (i.e., that she believed that Marlboro Lights delivered less tar or nicotine, or were safer or healthier, than other cigarettes), or, accordingly, that she suffered an injury which was caused by any such deception. (*See Aspinall v. Philip Morris Companies, Inc.,* 2004 Mass. Lexis 501 [Sup. Jud. Court of Mass August 13, 2004]).

CONCLUSION AND ORDER

***9** For the foregoing reasons, it is hereby

ORDERED that defendant's motion for summary judgment is granted, and the complaint is dismissed; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Counsel are hereby directed to obtain an accurate copy of this Court's opinion from the record room and not to rely on decisions obtained from the internet which have been altered in the scanning process.

N.Y.Sup.,2004.
Levine v. Philip Morris Inc.
5 Misc.3d 1004(A), 798 N.Y.S.2d 710, 2004 WL 2334287 (N.Y.Sup.), 2004 N.Y. Slip Op. 51177(U)

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Time Warner Cable, Inc. v. DIRECTV, Inc.
C.A.2 (N.Y.),2007.
Only the Westlaw citation is currently available.
United States Court of Appeals,Second Circuit.
TIME WARNER CABLE, INC., Plaintiff-Appellee,
v.
DIRECTV, INC., Defendant-Appellant.
No. 07-0468-cv.

Argued May 29, 2007.
Decided Aug. 9, 2007.

Interlocutory appeal from an opinion and order of the United States District Court for the Southern District of New York (Laura Taylor Swain, *Judge)* issued February 5, 2007, preliminarily enjoining DIRECTV, Inc. from disseminating, in any market in which Time Warner Cable, Inc. provides cable service, certain television commercials and Internet advertisements found to likely violate the Lanham Act on literal falsity grounds.
Affirmed in Part, Vacated in Part, and Remanded.

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Daniel H. Bromberg, Quinn Emanuel Urquhart Oliver & Hedges, LLP, Redwood Shores, CA (Marc L. Greenwald, Sanford I. Weisburst, Quinn Emanuel Urquhart Oliver & Hedges, LLP, New York, NY; Michael E. Williams, Justin C. Griffin, A.J. Bedel, Quinn Emanuel Urquhart Oliver & Hedges, LLP, Los Angeles, CA; and Margret Caruso, Quinn Emanuel Urquhart Oliver & Hedges, LLP, Redwood Shores, CA, on the brief), for Defendant-Appellant.

Before KEARSE, STRAUB, and POOLER, Circuit Judges.
STRAUB, Circuit Judge.
*1 Defendant-Appellant DIRECTV, Inc. (" DIRECTV") appeals from the February 5, 2007 opinion and order of the United States District Court for the Southern District of New York (Laura Taylor Swain, *Judge)* preliminarily enjoining it from disseminating, in any market in which Plaintiff-Appellee Time Warner Cable, Inc. (" TWC") provides cable service, certain television commercials and Internet advertisements found likely to violate the Lanham Act on literal falsity grounds. *Time Warner Cable, Inc. v. DIRECTV, Inc.,* 475 F.Supp.2d 299 (S.D.N.Y.2007).

This appeal requires us to clarify certain aspects of our false advertising doctrine. We make three clarifications in particular. First, we hold that an advertisement can be literally false even though it does not explicitly make a false assertion, if the words or images, considered in context, necessarily and unambiguously imply a false message. Second, we decide that the category of non-actionable " puffery" encompasses visual depictions that, while factually inaccurate, are so grossly exaggerated that no reasonable consumer would rely on them in navigating the marketplace. Third, we conclude that the likelihood of irreparable harm may be presumed where the plaintiff demonstrates a likelihood of success in showing that the defendant's comparative advertisement is literally false and that given the nature of the market, it would be obvious to the viewing audience that the advertisement is targeted at the plaintiff, even though the plaintiff is not identified by name. Reviewing the District Court's decision under these principles, we affirm in part, vacate in part, and remand for further proceedings consistent with this opinion.

FACTUAL BACKGROUND[FN1]

A. The Parties

TWC and DIRECTV are major players in the multichannel video service industry. TWC is the second-largest cable company in the United States, serving more than 13.4 million subscribers. Like all cable providers, TWC must operate through franchises let by local government entities; it is currently the franchisee in the greater part of New York City. DIRECTV is one of the country's largest satellite service providers, with more than 15.6 million customers nationwide. Because DIRECTV broadcasts directly via satellite, it is not subject to the same franchise limitations as cable companies. As a result, in the markets where TWC is the franchisee, DIRECTV and other satellite providers pose the greatest threat to its market share. The competition in these markets for new customers is extremely fierce, a fact to which the advertisements challenged in this case attest.

TWC offers both analog and digital television services to its customers. DIRECTV, on the other hand, delivers 100% of its programming digitally. Both companies, however, offer high-definition (" HD") service on a limited number of their respective channels. Transmitted at 1 a higher resolution than analog or traditional digital programming, HD provides the home viewer with theater-like picture quality on a wider screen. The picture quality of HD is governed by standards recommended by the Advanced Television Systems Committee (" ATSC"), an international non-profit organization that develops voluntary standards for digital television. To qualify as HD under ATSC standards, the screen resolution of a television picture must be at least 720p or 1080i.[FN2] TWC and DIRECTV do not set or alter the screen resolution for HD programming provided by the networks; instead, they make available sufficient bandwidth to permit the HD level of resolution to pass on to their customers. To view programming in HD format, customers of either provider must have an HD television set.

***2** There is no dispute, at least on the present record, that the HD programming provided by TWC and DIRECTV is equivalent in picture quality. In terms of non-HD programming, digital service generally yields better picture quality than analog service, because a digital signal is more resistant to interference. *See* Consumer Elecs. Ass'n v. F.C.C., 347 F.3d 291, 293-94 (D.C.Cir.2003). That said, TWC's analog cable service satisfies the technical specifications, *e.g.* signal level requirements and signal leakage limits, set by the Federal Communications Commission (" FCC"). *See* 47 C.F.R. § 76. 1, *et seq.* According to a FCC fact sheet, analog service that meets these specifications produces a picture that is " high enough in quality to provide enjoyable viewing with barely perceptible impairments."

B. DIRECTV's " SOURCE MATTERS" Campaign

In the fall of 2006, DIRECTV launched a multimedia advertising campaign based on the theme of " SOURCE MATTERS." The concept of the campaign was to educate consumers that to obtain HD-standard picture quality, it is not enough to buy an HD television set; consumers must also receive HD programming from the " source," *i.e.,* the television service provider.

1. Jessica Simpson Commercial

As part of its new campaign, DIRECTV began running a television commercial in October 2006 featuring celebrity Jessica Simpson. In the commercial, Simpson, portraying her character of Daisy Duke from the movie *The Dukes of Hazzard,* says to some of her customers at the local diner:

Simpson: Y'all ready to order?

Hey, 253 straight days at the gym to get this body and you're not gonna watch me on DIRECTV HD?

You're just not gonna get the best picture out of some fancy big screen TV without DIRECTV.

It's broadcast in 1080i. I totally don't know what that means, but I want it.

The original version of the commercial concluded with a narrator saying, " For picture quality that beats cable, you've got to get DIRECTV."

In response to objections by TWC, and pursuant to agreements entered into by the parties, DIRECTV pulled the original version of the commercial and replaced it with a revised one (" Revised Simpson Commercial"), which began airing in early December 2006. The Revised Simpson Commercial is identical to the original, except that it ends with a different tag line: " For an HD picture that can't be beat, get DIRECTV."

2. William Shatner Commercial

DIRECTV debuted another commercial in October 2006, featuring actor William Shatner as Captain James T. Kirk, his character from the popular *Star Trek* television show and film series. The following conversation takes place on the Starship Enterprise:

Mr. Chekov: Should we raise our shields, Captain?

Captain Kirk: At ease, Mr. Chekov.

Again with the shields. I wish he'd just relax and enjoy the amazing picture clarity of the DIRECTV HD we just hooked up.

***3** With what Starfleet just ponied up for this big screen TV, settling for cable would be illogical.

Mr. Spock: [Clearing throat.]

Captain Kirk: What, I can't use that line?

The original version ended with the announcer saying, " For picture quality that beats cable, you've got to get DIRECTV."

DIRECTV agreed to stop running the Shatner commercial in November 2006. In January 2007, DIRECTV released a revised version of the commercial (" Revised Shatner Commercial") with the revamped tag line, " For an HD picture that can't be beat, get DIRECTV."

3. Internet Advertisements

DIRECTV also waged its campaign in cyberspace, placing banner advertisements on various websites to promote the message that when it comes to picture quality, " source matters." The banner ads have the same basic structure. They open by showing an image that is so highly pixelated that it is impossible to discern what is being depicted. On top of this indistinct image is superimposed the slogan, " SOURCE MATTERS." After about a second, a vertical line splits the screen into two parts, one labeled " OTHER TV" and the other " DIRECTV." On the OTHER TV side of the line, the picture is extremely pixelated and distorted, like the opening image. By contrast, the picture on the DIRECTV side is exceptionally sharp and clear. The DIRECTV screen reveals that what we have been looking at all along is an image of New York Giants quarterback Eli Manning; in another ad, it is a picture of two women snorkeling in tropical waters. The advertisements then invite browsers to " FIND OUT WHY DIRECTV' S picture beats cable" and to " LEARN MORE" about a special offer. In the original design, users who clicked on the " LEARN MORE" icon were automatically directed to the HDTV section of DIRECTV's website.

In addition to the banner advertisements, DIRECTV created a demonstrative advertisement that it featured on its own website. Like the banner ads, the website demonstrative uses the split-screen technique to compare the picture quality of " DIRECTV" to that of " OTHER TV," which the ad later identifies as representing " basic cable," *i.e.,* analog cable. The DIRECTV side of the screen depicts, in high resolution, an image of football player Kevin Dyson making a touchdown at the Super Bowl. The portion of the image on the OTHER TV side is noticeably pixelated and blurry. This visual display is accompanied by the following text: " If you're hooking up your high-definition TV to basic cable, you're not getting the best picture on every channel. For unparalleled clarity, you need DIRECTV HD. You'll enjoy 100% digital picture and sound on every channel and also get the most sports in HD-including all your favorite football games in high definition with NFL SUNDAY TICKET."

PROCEDURAL HISTORY

A. Filing of Action and Stipulation

On December 7, 2006, TWC filed this action charging DIRECTV with, *inter alia,* false advertising in violation of § 43(a) of the Lanham Act. 15 U.S.C. § 1114, *et seq.* Initial negotiations led to the execution of a stipulation, in which DIRECTV agreed that pending final resolution of the action, it would stop running the original versions of the Simpson and Shatner commercials and also disable the link on the banner advertisements that routed customers to the HDTV page of its website. DIRECTV further stipulated that it would not claim in any advertisement, either directly or by implication, that " the picture quality presently offered by DIRECTV's HDTV service is superior to the picture offered presently by Time Warner Cable's HDTV service, or the present HDTV services of cable television providers in general." Finally, DIRECTV agreed that any breach of the stipulation would result in irreparable harm to TWC. The stipulation contained the caveat, however, that nothing in it " shall be construed to be a finding on the merits of this action." The District Court entered an order on the stipulation on December 12, 2006.

B. Preliminary Injunction Motion

***4** The following week, on December 18, TWC filed a motion for a preliminary injunction against the Revised Simpson Commercial, as well as the banner advertisements and website demonstrative (collectively, " Internet Advertisements"), none of which were specifically covered by the stipulation. TWC claimed that each of these advertisements was literally false, obviating the need for extrinsic evidence of consumer confusion. TWC further argued that as DIRECTV's direct competitor, it was entitled to a presumption of irreparable injury. On January 4, 2007, after discovering that DIRECTV had started running the Revised Shatner Commercial, TWC filed supplemental papers requesting that this commercial also be preliminarily enjoined on literal falsity grounds.

DIRECTV vigorously opposed the motion. It asserted that the Revised Simpson and Shatner Commercials were not literally false because no single statement in the commercials explicitly claimed that DIRECTV

HD is superior to cable HD in terms of picture quality. DIRECTV did not deny that the Internet Advertisements' depictions of cable were facially false. Rather, it argued that the Internet Advertisements did not violate the Lanham Act because the images constituted non-actionable puffery. Finally, DIRECTV argued that irreparable harm could not be presumed because none of the contested advertisements identified TWC by name.

C. The District Court's February 5, 2007 Opinion and Order

On February 5, 2007, the District Court issued a decision granting TWC's motion. The District Court determined that TWC had met its burden of showing that each of the challenged advertisements was likely to be proven literally false. Addressing the television commercials, the District Court held that the meaning of particular statements had to be determined in light of the overall context, and not in a vacuum as urged by DIRECTV. Given the commercials' obvious focus on HD picture quality, the District Court found that the Simpson's assertion that a viewer cannot " get the best picture out of some big fancy big screen TV without DIRECTV" and Shatner's quip that " settling for cable would be illogical" could only be understood as making the literally false claim that DIRECTV HD is superior to cable HD in picture quality. *See Time Warner Cable, Inc.,* 475 F.Supp.2d at 305-06. As for the Internet Advertisements, the District Court found that the facially false depictions of cable's picture quality could not be discounted as mere puffery because it was possible that consumers unfamiliar with HD technology would actually rely on the images in deciding whether to hook up their HD television sets to DIRECTV or analog cable. *See id.* at 306-08.

In assessing irreparable harm *vel non,* the District Court observed that under Second Circuit case law, irreparable harm could be presumed where the movant " demonstrates a likelihood of success in showing literally false defendant's comparative advertisement which mentions plaintiff's product by name." *Id.* at 308 (quoting *Castrol, Inc. v. Quaker State Corp.,* 977 F.2d 57, 62 (2d Cir.1992) (internal quotation marks omitted)). The District Court acknowledged that the Revised Shatner Commercial and the Internet Advertisements did not specifically name TWC, but concluded that a presumption of irreparable harm was nevertheless appropriate because the advertisements made explicit references to " cable," and in the markets where TWC is the franchisee, " cable" is functionally synonymous with " Time Warner Cable." *See id.* As for the Revised Simpson Commercial, the District Court reasoned that although the advertisement did not explicitly reference " cable," irreparable harm should be presumed because " TWC is DIRECTV's main competitor in markets served by TWC." *Id.* The District Court further noted that DIRECTV had breached the stipulation by continuing to run the contested commercials and that this breach also supported a finding of irreparable harm. *See id.* at n. 5.

***5** In accordance with its opinion, the District Court entered a preliminary injunction barring DIRECTV from disseminating, " in any market in which [TWC] provides cable service,"
(1) the Revised Simpson Commercial and Revised Shatner Commercial, " and any other advertisement disparaging the visual or audio quality of TWC or cable high-definition (" HDTV") programming as compared to that of DIRECTV or satellite HDTV programming" ; and
(2) the Internet Advertisements " and any other advertisement making representations that the service provided by Time Warner Cable, or cable service in general, is unwatchable due to blurriness, distortion, pixellation or the like, or inaudible due to static or other interference."

DISCUSSION

A party seeking preliminary injunctive relief must establish: (1) either (a) a likelihood of success on the merits of its case or (b) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly in its favor, *and* (2) a likelihood of irreparable harm if the requested relief is denied. *See Coca-Cola Co. v. Tropicana Prods., Inc.,* 690 F.2d 312, 314-15 (2d Cir.1982), *abrogated on other grounds by* Fed.R.Civ.P. 52(a). We review the entry of a preliminary injunction for excess of discretion, which may be found where the district court, in issuing the injunction, relied upon clearly erroneous findings of fact or errors of law. *S.C. Johnson & Son, Inc. v. Clorox Co.,* 241 F.3d 232, 237 (2d Cir.2001). " [T]he district judge's determination of the meaning of the advertisement [is] a finding of fact that shall not be set aside unless clearly erroneous." *Id.* (alterations in original; internal quotation marks omitted); *see also* Johnson & Johnson v. GAC Int'l, Inc., 862 F.2d 975, 979 (2d Cir.1988) (" *GAC Int'l, Inc.*").

A. Likelihood of Success on the Merits

1. Television Commercials

Section 43(a) of the Lanham Act provides, in pertinent part that:

Any person who, on or in connection with any goods or services ... uses in commerce ... any ... false or misleading description of fact, or false or misleading representation of fact, which-

....

(B) in commercial advertising or promotion, misrepresents the nature, characteristics, qualities, or geographic origin of his or her or another person's goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

15 U.S.C. § 1125(a)(1).

Two different theories of recovery are available to a plaintiff who brings a false advertising action under § 43(a) of the Lanham Act. First, the plaintiff can demonstrate that the challenged advertisement is literally false, *i.e.*, false on its face. *See* GAC Int'l, Inc., 862 F.2d at 977. When an advertisement is shown to be literally or facially false, consumer deception is presumed, and " the court may grant relief without reference to the advertisement's [actual] impact on the buying public." Coca-Cola Co., 690 F.2d at 317. " This is because plaintiffs alleging a literal falsehood are claiming that a statement, on its face, conflicts with reality, a claim that is best supported by comparing the statement itself with the reality it purports to describe." Schering Corp. v. Pfizer Inc., 189 F.3d 218, 229 (2d Cir.1999).

***6** Alternatively, a plaintiff can show that the advertisement, while not literally false, is nevertheless likely to mislead or confuse consumers. *See* Coca-Cola Co., 690 F.2d at 317. " [P]laintiffs alleging an implied falsehood are claiming that a statement, whatever its literal truth, has left an impression on the listener [or viewer] that conflicts with reality" -a claim that " invites a comparison of the impression, rather than the statement, with the truth." Schering Corp., 189 F.3d at 229. Therefore, whereas " plaintiffs seeking to establish a literal falsehood must generally show the substance of what is conveyed, ... a district court *must* rely on extrinsic evidence [of consumer deception or confusion] to support a finding of an implicitly false message." *Id.* (internal quotation marks omitted).[FN3]

Here, TWC chose to pursue only the first path of literal falsity, and the District Court granted the preliminary injunction against the television commercials on that basis. In this appeal, DIRECTV does not dispute that it would be a misrepresentation to claim that the picture quality of DIRECTV HD is superior to that of cable HD. Rather, it argues that neither commercial explicitly makes such a claim and therefore cannot be literally false.

a. Revised Simpson Commercial

DIRECTV's argument is easily dismissed with respect to the Revised Simpson Commercial. In the critical lines, Simpson tells audiences, " You're just not gonna get the best picture out of some fancy big screen TV without DIRECTV. It's broadcast in 1080i." These statements make the explicit assertion that it is impossible to obtain " the best picture" -*i.e.,* a " 1080i" -resolution picture-from any source other than DIRECTV. This claim is flatly untrue; the uncontroverted factual record establishes that viewers can, in fact, get the same " best picture" by ordering HD programming from their cable service provider. We therefore affirm the District Court's determination that the Revised Simpson Commercial's contention " that a viewer cannot ' get the best picture' without DIRECTV is ... likely to be proven literally false." Time Warner Cable, Inc., 475 F.Supp.2d at 306.

b. Revised Shatner Commercial

The issue of whether the Revised Shatner Commercial is likely to be proven literally false requires more analysis. When interpreting the controversial statement, " With what Starfleet just ponied up for this big screen TV, settling for cable would be illogical," the District Court looked not only at that particular text, but also at the surrounding context. In light of Shatner's opening comment extolling the " amazing picture quality of [ ] DIRECTV HD" and the announcer's closing remark highlighting the unbeatable " HD picture" provided by DIRECTV, the District Court found that the line in the middle-" settling for cable would be illogical" -

clearly referred to cable's HD picture quality. Since it would only be " illogical" to " settle" for cable's HD picture if it was materially inferior to DIRECTV's HD picture, the District Court concluded that TWC was likely to establish that the statement was literally false.

***7** DIRECTV argues that the District Court's ruling was clearly erroneous because the actual statement at issue, " settling for cable would be illogical," does not explicitly compare the picture quality of DIRECTV *HD* with that of cable *HD,* and indeed, does not mention *HD* at all. In DIRECTV's view, the District Court based its determination of literal falsity not on the words actually used, but on what it subjectively perceived to be the general message conveyed by the commercial as a whole. DIRECTV contends that this was plainly improper under this Court's decision in *American Home Products Corp. v. Johnson & Johnson,* 577 F.2d 160 (2d Cir.1978).

TWC, on the other hand, maintains that the District Court properly took context into account in interpreting the commercial, as directed by this Court in *Avis Rent A Car System, Inc. v. Hertz Corp.,* 782 F.2d 381 (2d Cir.1986). TWC argues that under *Avis Rent A Car,* an advertisement can be literally false even though no " combination of words between two punctuation signals" is untrue, if the clear meaning of the statement, considered in context, is false. Given the commercial's repeated references to " HD picture," TWC contends that the District Court correctly found that " settling for cable would be illogical" literally made the false claim that cable's HD picture quality is inferior to DIRECTV's.

To appreciate the parties' dispute, it is necessary to understand the two key cases, *American Home Products* and *Avis Rent A Car.* The *American Home Products* case involved a false advertising claim asserted by McNeil Laboratories, Inc., the manufacturer of Tylenol, against American Home Products Corporation, the manufacturer of the competing drug Anacin. One of the challenged advertisements was a television commercial, in which a spokesman told consumers:

Your body knows the difference between these pain relievers [showing other products] and Adult Strength Anacin. For pain other than headache Anacin reduces the inflammation that often comes with pain. These do not. Specifically, inflammation of tooth extraction[,] muscle strain[,] backache [,] or if your doctor diagnoses tendonitis [,] neuritis. Anacin reduces that inflammation as Anacin relieves pain fast. These do not. Take Adult Strength Anacin.

Am. Home Prods., 577 F.2d at 163 n. 3 (notations of special effects omitted). Another advertisement, which appeared in national magazines, advised readers:

Anacin can reduce inflammation that comes with most pain. Tylenol cannot.
With any of these pains, your body knows the difference between the pain reliever in Adult-Strength Anacin and other pain relievers like Tylenol. Anacin can reduce the inflammation that often comes with these pains.
Tylenol cannot. Even Extra-Strength Tylenol cannot. And Anacin relieves pain fast as it reduces inflammation.

Id. at 163 n. 4. The print advertisement visually depicted the aforementioned " pains" as spots located on a human body, correlating to tooth extraction, muscle strain, muscular backache, tendonitis, neuritis, sinusitis, and sprains. *Id.*

***8** To ascertain the meaning of these advertisements, the district court turned to consumer reaction surveys. *See id.* at 163. Based on these surveys, it found that: (1) the television commercial represented that Anacin is a superior pain reliever generally, and not only with reference to the particular conditions enumerated in the commercial or to Anacin's alleged ability to reduce inflammation; (2) the print advertisement claimed that Anacin is a superior analgesic for certain kinds of pain because Anacin can reduce inflammation; and (3) both advertisements represented that Anacin reduces inflammation associated with the conditions specified in the ads. *Id.* at 163-64. The district court determined that the first two claims were factually false. *Id.* at 164. Although the district court did not definitively decide the veracity of the third claim, it reasoned that " because the three claims [were] ' integral and inseparable,' the advertisements as a whole" violated the Lanham Act. *Id.* (internal quotations and citation omitted).

American Home Products appealed, arguing that since the advertisements did not contain an *express* claim for greater analgesia, they could not violate § 43(a), even if consumers mistakenly perceived a different and incorrect meaning. *See id.* This Court disagreed. It first observed that " [§] 43(a) of the

Lanham Act encompasses more than literal falsehoods" ; implied falsehoods are also prohibited. *Id.* at 165. The Court emphasized, however, that when an advertisement relies on " clever use of innuendo, indirect intimations, and ambiguous suggestions," instead of literally false statements, the truth or falsity of the ad " usually should be tested by the reactions of the public." *Id* . It provided district courts with the following guidance for analyzing a claim of implied falsity:

A court may, of course, construe and parse the language of the advertisement. It may have personal reactions as to the defensibility or indefensibility of the deliberately manipulated words. It may conclude that the language is far from candid and would never pass muster under tests otherwise applied-for example, the Securities Acts' injunction that " thou shalt disclose" ; but the court's reaction is at best not determinative and at worst irrelevant. *The question in such cases is-what does the person to whom the advertisement is addressed find to be the message?*

Id. at 165-66 (quoting *Am. Brands, Inc. v. R.J. Reynolds Tobacco Co.,* 413 F.Supp. 1352, 1357 (S.D.N.Y.1976)).

Applying these principles to the facts of the case, the *American Home Products* Court determined that " the district court's use of consumer response data was proper" because " the claims of both the television commercial and the print advertisement [were] ambiguous." *Id.* at 166. " This obscurity," the Court explained, " [wa]s produced by several references to ' pain' and body sensation accompanying the assertions that Anacin reduces inflammation." *Id.* Therefore, " [a] reader of or listener to these advertisements could reasonably infer that Anacin is superior to Tylenol in reducing pain generally (Claim One) and in reducing certain kinds of pain (Claim Two)." *Id.* " Given this rather obvious ambiguity," the Court concluded that the district judge " was warranted in examining, and may have been compelled to examine, consumer data to determine first the messages conveyed in order to determine ultimately the truth or falsity of the messages." *Id.* (footnote omitted).

9** *American Home Products* dealt with a claim of implied falsity. *See id.* at 165 (" We are dealing not with statements which are literally or grammatically untrue.... Rather, we are asked to determine whether a statement acknowledged to be *literally true and grammatically correct nevertheless has a tendency to mislead, confuse or deceive.*" (quoting *Am. Brands, Inc.,* 413 F.Supp. at 1357)). In *Avis Rent A Car,* the false advertising action was premised on a theory of literal, not implied, falsity. In the facts of that case, Avis Rent A Car System, Inc., the self-proclaimed " Number 2" in the car rental business, sued " Number 1" Hertz Corporation over an advertisement that proclaimed, in large bold print, that " **Hertz has more new cars than Avis has cars.**" *Avis Rent A Car,* 782 F.2d at 381-82. Below a picture of mechanics unloading new cars into an airport parking lot, the advertisement went on to explain: " If you'd like to drive some of the newest cars on the road, rent from Hertz. Because we have more new 1984 cars than Avis or anyone else has cars-new or old.... Whether you're renting for business or pleasure, chances are you'll find a domestic or imported car you'll want to drive." *Id.* at 382. At the bottom of the ad was Hertz's slogan, " ***The # 1 way to rent a car." *Id.*

At the time the advertisement was published, Hertz only had about 97,000 1984 model cars, whereas Avis had a total of approximately 102,000 cars. *See id.* at 383. However, 6776 cars in Avis's fleet were in the process of being sold and were no longer available for rental. *Id.* at 384. Thus, the literal truth or falsity of the claim that " Hertz has more new cars than Avis has cars" turned on whether the statement " referred to the rental fleets or the total fleets of the two companies." *Id.* at 383. The district court found that because the advertisement said " cars," and not " cars for rent," it had to be read as referring to the companies' total fleets and, as such, was literally false. *See id.* at 384.

This Court held that the district court's finding was clearly erroneous. It pointed out that the parties had " made their reputations as companies that *rent* cars, not companies that sell or merely own cars," and that the advertisement had appeared " in publications that would come to the attention of prospective renters, not car buyers or financial analysts." *Id.* at 385. Moreover, the advertisement featured a large picture of an airport rental lot and made three specific references to rentals. *See id.* Taking this context into consideration, the Court concluded that the claim that " Hertz has more new cars than Avis has new cars" could only be understood as referring to the companies' rental fleets. The Court elaborated:

Fundamental to any task of interpretation is the principle that text must yield to context. Recognizing this, the Supreme Court long ago inveighed against " the tyranny of literalness." In his determination to " go by the written word" and to ignore the context in which the words were used, the district judge in the present case failed to heed the familiar warning of Judge Learned Hand that " [t]here is no surer way to misread any document than to read it literally," as well as his oft-cited admonition that " it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary."

***10** These and similar invocations against literalness, though delivered most often in connection with statutory and contract interpretation, are relevant to the interpretation of any writing, including advertisements. Thus, we have emphasized that in reviewing FTC actions prohibiting unfair advertising practices under the Federal Trade Commission Act a court must " consider the advertisement in its entirety and not ... engage in disputatious dissection. The entire mosaic should be viewed rather than each tile separately." ... Similar approaches have been taken in Lanham Act cases involving the claim that an advertisement was false on its face.

Id. at 385 (citations omitted).

At first glance, *American Home Products* and *Avis Rent A Car* may appear to conflict. *American Home Products* counsels that when an advertisement is not false on its face, but instead relies on indirect intimations, district courts should look to consumer reaction to determine meaning, and not rest on their subjective impressions of the advertisement as a whole. *Avis Rent A Car,* on the other hand, instructs district courts to consider the overall context of an advertisement to discern its true meaning, and holds that the message conveyed by an advertisement may be viewed as not false in the context of the business at issue, even though the written words are not literally accurate.

On closer reading, however, the two cases can be reconciled. In *American Home Products,* we did not say that context is irrelevant or that courts are myopically bound to the explicit words of an advertisement. Rather, we held that where it is " clear that ... the language of the advertisement[ ] is not unambiguous," the district court should look to consumer response data to resolve the ambiguity. *Am. Home Prods.,* 577 F.2d at 164. In *Avis Rent A Car,* we concluded that there was no ambiguity to resolve because even though the statement, " Hertz has more new cars than Avis has cars," did not expressly qualify the comparison, given the surrounding context, it " unmistakably" referred to the companies' rental fleets. *Avis Rent A Car,* 782 F.2d at 384.

These two cases, read together, compel us to now formally adopt what is known in other circuits as the " false by necessary implication" doctrine. *See, e.g., Scotts Co. v. United Indus. Corp.,* 315 F.3d 264, 274 (4th Cir.2002); *Clorox Co. Puerto Rico v. Proctor & Gamble Commercial Co.,* 228 F.3d 24, 34-35 (1st Cir.2000); *Southland Sod Farms v. Stover Seed Co.,* 108 F.3d 1134, 1139 (9th Cir.1997); *Castrol Inc. v. Pennzoil Co.,* 987 F.2d 939, 946-47 (3d Cir.1993) *(" Pennzoil Co.").*[FN4] Under this doctrine, a district court evaluating whether an advertisement is literally false " must analyze the message conveyed in full context," *Pennzoil Co.,* 987 F.2d at 946, *i.e.,* it " must consider the advertisement in its entirety and not ... engage in disputatious dissection," *Avis Rent A Car,* 782 F.2d at 385 (internal quotation marks omitted). If the words or images, considered in context, necessarily imply a false message, the advertisement is literally false and no extrinsic evidence of consumer confusion is required. *See Novartis Consumer Health, Inc. v. Johnson & Johnson-Merck Pharm. Co.,* 290 F.3d 578, 586-87 (3d Cir.2002) (" A ' literally false' message may be either explicit or ' conveyed by necessary implication when, considering the advertisement in its entirety, the audience would recognize the claim as readily as if it had been explicitly stated.' " (quoting *Clorox Co. Puerto Rico,* 228 F.3d at 35)). However, " only an *unambiguous* message can be literally false." *Id.* at 587. Therefore, if the language or graphic is susceptible to more than one reasonable interpretation, the advertisement cannot be literally false. *See Scotts Co.,* 315 F.3d at 275 (stating that a literal falsity argument fails if the statement or image " can reasonably be understood as conveying different messages"); *Clorox Co. Puerto Rico,* 228 F.3d at 35 (" [A] factfinder might conclude that the message conveyed by a particular advertisement remains so balanced between several plausible meanings that the claim made by the advertisement is too uncertain to serve as the basis of a literal falsity claim...."). There may still be a " basis for a claim that the advertisement is misleading," *Clorox Co. Puerto Rico,* 228 F.3d at 35, but to resolve such a claim, the district court must look to consumer data to determine what " the person to whom the advertisement is addressed find[s] to be the message," *Am. Home Prods.,* 577 F.2d at 166 (citation omitted). In short, where the advertisement does not unambiguously make a claim, " the court's reaction is at best not determinative and at worst irrelevant." *Id.*

***11** Here, the District Court found that Shatner's assertion that " settling for cable would be illogical," considered in light of the advertisement as a whole, unambiguously made the false claim that cable's HD picture quality is inferior to that of DIRECTV's. We cannot say that this finding was clearly erroneous, especially given that in the immediately preceding line, Shatner praises the " amazing picture clarity of DIRECTV HD." We accordingly affirm the District Court's conclusion that TWC established a likelihood of success on its claim that the Revised Shatner Commercial is literally false.

2. Internet Advertisements

We have made clear that a district court must examine not only the words, but also the " visual images ... to assess whether [the advertisement] is literally false." S.C. Johnson & Son, Inc. ., 241 F.3d at 238. It is uncontroverted that the images used in the Internet Advertisements to represent cable are inaccurate depictions of the picture quality provided by cable's digital or analog service. The Internet Advertisements are therefore explicitly and literally false. *See* Coca-Cola Co., 690 F.2d at 318 (reversing the district court's finding of no literal falsity in an orange juice commercial where " [t]he visual component of the ad makes an explicit representation that Premium Pack is produced by squeezing oranges and pouring the freshly-squeezed juice directly into the carton. This is not a true representation of how the product is prepared. Premium Pack juice is heated and sometimes frozen prior to packaging.").

DIRECTV does not contest this point. Rather, it asserts that the images are so grossly distorted and exaggerated that no reasonable buyer would take them to be accurate depictions " of how a consumer's television picture would look when connected to cable." Consequently, DIRECTV argues, the images are obviously just puffery, which cannot form the basis of a Lanham Act violation. Notably, TWC agrees that no Lanham Act action would lie against an advertisement that was so exaggerated that no reasonable consumer would rely on it in making his or her purchasing decisions. TWC contends, however, that DIRECTV's own evidence-which indicates that consumers are highly confused about HD technology-shows that the Internet Advertisements pose a real danger of consumer reliance.

This Court has had little occasion to explore the concept of puffery in the false advertising context. In *Lipton v. Nature Co.,* 71 F.3d 464 (2d Cir.1995), the one case where we discussed the subject in some depth, we characterized puffery as " [s]ubjective claims about products, which cannot be proven either true or false." *Id.* at 474 (internal quotation marks omitted). We also cited to the Third Circuit's description of puffery in *Pennzoil Co.:* " Puffery is an exaggeration or overstatement expressed in broad, vague, and commendatory language. ' Such sales talk, or puffing, as it is commonly called, is considered to be offered and understood as an expression of the seller's opinion only, which is to be discounted as such by the buyer.... The ' puffing' rule amounts to a seller's privilege to lie his head off, so long as he says nothing specific.' " *Penzoil Co.,* 987 F.2d at 945 (quoting W. Page Keeton et al., *Prosser and Keeton on the Law of Torts* § 109, at 756-57 (5th ed.1984)). Applying this definition, we concluded that the defendant's contention that he had conducted " thorough" research was just puffery, which was not actionable under the Lanham Act. *See* *Lipton,* 71 F.3d at 474.

***12** *Lipton's* and *Pennzoil Co.'s* definition of puffery does not translate well into the world of images. Unlike words, images cannot be vague or broad. *Cf.* *Pennzoil Co.,* 987 F.2d at 945. To the contrary, visual depictions of a product are generally " specific and measurable," *id.* at 946, and can therefore " be proven either true or false," *Lipton,* 71 F.3d at 474 (internal quotation marks omitted), as this case demonstrates. Yet, if a visual representation is so grossly exaggerated that no reasonable buyer would take it at face value, there is no danger of consumer deception and hence, no basis for a false advertising claim. *Cf.* *Johnson & Johnson * Merck Consumer Pharm. Co. v. Smithkline Beecham Corp.,* 960 F.2d 294, 298 (2d Cir.1992) (" [T]he injuries redressed in false advertising cases are the result of public deception. Thus, where the plaintiff cannot demonstrate that a statistically significant part of the commercial audience holds the false belief allegedly communicated by the challenged advertisement, the plaintiff cannot establish that it suffered any injury as a result of the advertisement's message. Without injury there can be no claim, regardless of commercial context, prior advertising history, or audience sophistication."); *see also* U.S. Healthcare, Inc. v. Blue Cross of Greater Philadelphia, 898 F.2d 914, 922 (3d Cir.1990) (" Mere puffery, advertising that is not deceptive for no one would rely on its exaggerated claims, is not actionable under § 43(a)." (internal quotation marks omitted)).

Other circuits have recognized that puffery can come in at least two different forms. *See, e.g.,* Pizza Hut, Inc. v. Papa John's Int'l, Inc., 227 F.3d 489, 497 (5th Cir.2000). The first form we identified in *Lipton*-" a general claim of superiority over comparable products that is so vague that it can be understood as nothing more than a mere expression of opinion." *Id.; see* Lipton, 71 F.3d at 474. The second form of puffery, which we did not address in *Lipton,* is " an exaggerated, blustering, and boasting statement upon which no reasonable buyer would be justified in relying." *Pizza Hut, Inc.,* 227 F.3d at 497; *accord* United Indus. Corp. v. Clorox Co., 140 F.3d 1175, 1180 (8th Cir.1998) (" Puffery is exaggerated advertising, blustering, and boasting upon which no reasonable buyer would rely and is not actionable under § 43(a)." (internal quotation marks omitted)). We believe that this second conception of puffery is a better fit where, as here, the " statement" at issue is expressed not in words, but through images.

The District Court determined that the Internet Advertisements did not satisfy this alternative definition of puffery because DIRECTV's own evidence showed that " many HDTV equipment purchasers are confused as to what image quality to expect when viewing non-HD broadcasts, as their prior experience with the equipment is often limited to viewing HD broadcasts or other digital images on floor model televisions at large retail chains." *Time Warner Cable, Inc. .,* 475 F.Supp.2d at 307. Given this confusion, the District Court reasoned that " consumers unfamiliar with HD equipment could be led to believe that using an HD television set with an analog cable feed might result in the sort of distorted images showcased in DIRECTV's Internet Advertisements, especially since those advertisements make reference to ' basic cable.' " *Id.*

***13** Our review of the record persuades us that the District Court clearly erred in rejecting DIRECTV's puffery defense. The " OTHER TV" images in the Internet Advertisements are-to borrow the words of Ronald Boyer, TWC's Senior Network Engineer-" unwatchably blurry, distorted, and pixelated, and ... nothing like the images a customer would ordinarily see using Time Warner Cable's cable service." Boyer further explained that

the types of gross distortions shown in DIRECTV's Website Demonstrative and Banner Ads are not the type of disruptions that could naturally happen to an analog or non-HD digital cable picture. These advertisements depict the picture quality of cable television as a series of large colored square blocks, laid out in a grid like graph paper, which nearly entirely obscure the image. This is not the type of wavy or " snowy" picture that might occur from degradation of an unconverted analog cable picture, or the type of macro-blocking or " pixelization" that might occur from degradation of a digital cable picture. Rather, the patchwork of colored blocks that DIRECTV depicts in its advertisement appears to be the type of distortion that would result if someone took a low-resolution photograph and enlarged it too much or zoomed in too close. If DIRECTV intended the advertisement to depict a pixelization problem, this is a gross exaggeration of one.

As Boyer's declaration establishes, the Internet Advertisements' depictions of cable are not just inaccurate; they are not even remotely realistic. It is difficult to imagine that any consumer, whatever the level of sophistication, would actually be fooled by the Internet Advertisements into thinking that cable's picture quality is so poor that the image is " nearly entirely obscure [d]." As DIRECTV states in its brief, " even a person not acquainted with cable would realize TWC could not realistically supply an unwatchably blurry image and survive in the marketplace."

In reaching the contrary conclusion, the District Court relied heavily on the declaration of Jon Gieselman, DIRECTV's Senior Vice-President of Advertising and Public Relations. However, Gieselman merely stated that the common misconception amongst first-time purchasers of HD televisions is that " they will automatically get exceptional clarity on every channel" just by plugging their new television sets into the wall. Nothing in Gieselman's declaration indicates that consumers mistakenly believe that hooking up their HD televisions to an analog cable feed will produce an unwatchably distorted picture. More importantly, the Internet Advertisements do not claim that the " OTHER TV" is an HD television set, or that the corresponding images represent what happens when an HD television is connected to basic cable. The Internet Advertisements simply purport to compare the picture quality of DIRECTV's programming to that of basic cable programming, and as discussed above, the comparison is so obviously hyperbolic that " no reasonable buyer would be justified in relying" on it in navigating the marketplace. *Pizza Hut, Inc.,* 227 F.3d at 497.

***14** For these reasons, we conclude that the District Court exceeded its permissible discretion in preliminarily enjoining DIRECTV from disseminating the Internet Advertisements.

B. Irreparable Harm

A plaintiff seeking a preliminary injunction under the Lanham Act must persuade a court not only that it is likely to succeed on the merits, but also that it is likely to suffer irreparable harm in the absence of immediate relief. *See Coca-Cola Co.,* 690 F.2d at 316. Because " [i]t is virtually impossible to prove that so much of one's sales will be lost or that one's goodwill will be damaged as a direct result of a competitor's advertisement," we have resolved that a plaintiff " need not ... point to an actual loss or diversion of sales" to satisfy this requirement. *Id.* At the same time, " something more than a plaintiff's mere subjective belief that [it] is injured or likely to be damaged is required before [it] will be entitled even to injunctive relief." *Johnson & Johnson v. Carter-Wallace, Inc.,* 631 F.2d 186, 189 (2d Cir.1980). The rule in this Circuit, therefore, is that a plaintiff " must submit proof which provides a reasonable basis" for believing that the false advertising will likely cause it injury. *Coca-Cola Co.,* 690 F.2d at 316.

In general, " [t]he likelihood of injury and causation will not be presumed, but must be demonstrated in some manner." *Id.* We have held, however, that these elements may be presumed " where [the] plaintiff demonstrates a likelihood of success in showing literally false [the] defendant's comparative advertisement which mentions [the] plaintiff's product by name." *Castrol, Inc.,* 977 F.2d at 62. We explained the reason for the presumption in *McNeilab, Inc. v. American Home Products Corp.,* 848 F.2d 34 (2d Cir.1988). There, we observed that in the case of a " misleading, non-comparative commercial[ ] which tout[s] the benefits of the product advertised but ma[kes] no direct reference to any competitor's product," the injury " accrues equally to all competitors; none is more likely to suffer from the offending broadcasts than any other." *Id.* at 38. Thus, " some indication of actual injury and causation" is necessary " to satisfy Lanham Act standing requirements and to ensure [the] plaintiff's injury [is] not speculative." *Id.* By contrast, where the case presents a false comparative advertising claim, " the concerns ... regarding speculative injury do not arise." *Id.* This is because a false " comparison to a specific competing product necessarily diminishes that product's value in the minds of the consumer." *Id.* Accordingly, no proof of likely injury is necessary.

Although neither of the television commercials identifies TWC by name, the rationale for a presumption of irreparable harm applies with equal force to this case. The Revised Shatner Commercial explicitly disparages the picture quality of " cable." As the District Court found, TWC *is* " cable" in the areas where it is the franchisee. *Time Warner Cable, Inc.,* 475 F.Supp.2d at 308. Thus, even though Shatner does not identify TWC by name, consumers in the markets covered by the preliminary injunction would undoubtedly understand his derogatory statement, " settling for cable would be illogical," as referring to TWC. Because the Revised Shatner Commercial " necessarily diminishes" TWC's value " in the minds of the consumer," the District Court properly accorded TWC a presumption of irreparable harm. *McNeilab, Inc.,* 848 F.2d at 38.

***15** The Revised Simpson Commercial, unlike the original version pulled in December 2006, does not explicitly refer to " cable." However, the fact that the commercial does not name plaintiff's product is not necessarily dispositive. As we said in *Ortho Pharmaceutical Corp. v. Cosprophar, Inc.,* 32 F.3d 690 (2d Cir.1994), the application of the presumption is disfavored " where the products are not obviously in competition *or* where the defendant's advertisements make no direct reference to any competitor's products." *Id.* at 696 (emphasis added); *see also Hutchinson v. Pfeil,* 211 F.3d 515, 522 (10th Cir.2000) (" [T]he presumption [of irreparable injury] is properly limited to circumstances in which injury would indeed likely flow from the defendant's objectionable statements, i.e., when the defendant has explicitly compared its product to the plaintiff's or the plaintiff is an obvious competitor with respect to the misrepresented product." (citing *Ortho Pharm. Corp.,* 32 F.3d at 694)). According to a survey in the record, approximately 90% of households have either cable or satellite service. Given the nearly binary structure of the television services market, it would be obvious to consumers that DIRECTV's claims of superiority are aimed at diminishing the value of cable-which, as discussed above, is synonymous with TWC in the areas covered by the preliminary injunction. Therefore, although the Revised Simpson Commercial does not explicitly mention TWC or cable, it " necessarily diminishes" the value of TWC's product. *McNeilab, Inc.,* 848 F.2d at 38. The District Court thus did not err in presuming that TWC has " a reasonable basis" for believing that the advertisement will likely cause it injury. *Coca-Cola Co.,* 690 F.2d at 316. [FN5]

In sum, we conclude that the District Court did not exceed its allowable discretion in preliminarily enjoining the further dissemination of the Revised Simpson and Revised Shatner Commercials in any market where TWC is the franchisee. The District Court's order also forbids the dissemination of " any other advertisement disparaging the video or audio quality of TWC or cable high-definition (' HDTV') programming as compared to that of DIRECTV or satellite HDTV programming." As worded, this statement could be construed to prohibit the unfavorable comparison of even TWC's analog programming. To eliminate any ambiguity, we instruct the District Court to change the phrase " TWC or cable" to " TWC's or cable's," and the phrase " DIRECTV or satellite" to " DIRECTV's or satellite's."

CONCLUSION

For the foregoing reasons, we AFFIRM the preliminary injunction in part, VACATE it in part, and REMAND for further proceedings consistent with this opinion.

FN1. This factual background is derived from the District Court's findings of fact, which are not in dispute. *See Time Warner Cable, Inc.,* 475 F.Supp.2d at 302-04.

FN2. The " p" and " i" designations stand for " progressive" and " interlaced." In the progressive format, the full picture updates every sixtieth of a second, while in the interlaced format, half of the picture updates every sixtieth of a second. The higher the " p" or " i" number, the greater the resolution and the better the picture will appear to the viewer.

FN3. Under either theory, the plaintiff must also demonstrate that the false or misleading representation involved an inherent or material quality of the product. *See S.C. Johnson & Son, Inc.,* 241 F.3d at 238; *Nat'l Basketball Ass'n v. Motorola, Inc.,* 105 F.3d 841, 855 (2d Cir.1997). TWC has met this requirement, as it is undisputed that picture quality is an inherent and material characteristic of multichannel video service.

FN4. Several district courts in this Circuit have already embraced the doctrine. *See, e.g., Johnson & Johnson-Merck Consumer Pharm. Co. v. Procter & Gamble Co.,* 285 F.Supp.2d 389, 391 (S.D.N.Y.2003), *aff'd,* 90 Fed.Appx. 8 (2d Cir.2003); *Tambrands, Inc. v. Warner-Lambert Co.,* 673 F.Supp. 1190, 1193-94 (S.D.N.Y.1987).

FN5. Because we conclude that irreparable injury was properly presumed, we need not address the District Court's alternative rationale that DIRECTV's breach of the stipulation supports a finding of irreparable injury.

C.A.2 (N.Y.),2007.
Time Warner Cable, Inc. v. DIRECTV, Inc.
--- F.3d ----, 2007 WL 2263932 (C.A.2 (N.Y.))

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Whalen v. Pfizer, Inc.
N.Y.Sup.,2005.
NOTE: THIS OPINION WILL NOT BE PUBLISHED IN A PRINTED VOLUME. THE DISPOSITION WILL APPEAR IN A REPORTER TABLE.

Supreme Court, New York County, New York.
Kathleen WHALEN, on behalf of herself and all others similarly situated,, Plaintiff,
v.
PFIZER, INC., Defendant.
No. 600125/05.

Sept. 22, 2005.

RICHARD B. LOWE, J.

*1 Plaintiff Kathleen Whalen (" Whalen") moves, pursuant to CPLR 901, 902, and 904 for an order (1) determining that this action be maintained as a New York class action and (2) determining that defendant should bear the expense of notification under CPLR 904.

BACKGROUND

Plaintiff seeks class certification in this action for damages caused by defendants' alleged violations of General Business Law (" GBL") § 349 and for her common law claim of unjust enrichment.

Defendant Pfizer Inc. (" Pfizer") manufactures and markets Listerine Antiseptic Mouthrinse (" Listerine"). As has been indicated on its labels, Listerine has been accepted by the American Dental Association (" ADA") as safe and effective in reducing plaque and gingivitis.

Starting in June, 2004, Pfizer represented through its advertising that Listerine is " as effective as floss" and that this claim was " clinically proven." The use of floss is an effective measure in removing plaque between the teeth. Indeed, the ADA recommends brushing twice a day and cleaning between the teeth with floss or interdental cleaners once each day to remove plaque from all tooth surfaces. According to Johnson & Johnson, Inc. (" J & J"), a leading maker of dental flossing products, while 90% of Americans have dental floss at home, 63% report they do not floss as often as they should (*see* Smart Aff, Ex. 10). However, J & J points out that " in practice, nearly 90 percent do not floss as often as they should" (*id.*).

Pfizer launched an advertising campaign known as " Big Bang." These commercials included such statements as " Listerine's as effective as floss" and " [s]o even if you don't floss like you should, now you can get its healthy benefits from simply rinsing." They also incorporated the statement " floss daily" in small print. In August of 2004, a revised commercial was aired, with statements such as " Listerine's as effective as floss," " clinical studies prove it," and " [o]f course, you should floss but if you don't floss like you should, you can get floss' plaque-fighting benefits by rinsing" as part of the advertisement. In September of 2004, Pfizer aired a second revised commercial, essentially communicating the same message.

Print advertisements were also shown during the same period of time, printed with the statement, " Only Listerine Antiseptic is clinically proven to be as effective as floss" with the remainder of the sentence " at reducing plaque and gingivitis between the teeth" in smaller print. These print advertisements did not otherwise include substance regarding the use of floss.

On September 28, 2004, McNeil-PPC, Inc., a division of J & J, brought suit against Pfizer for, *inter alia,* violation of section 43(a) of the Lanham Act, 15 USC § 1125(a), relating to the Listerine advertising campaign. A motion for preliminary injunction was granted against Pfizer, and the advertisements and labeling on Listerine bottles were accordingly changed. *See* McNeil-PPC, Inc. v.. Pfizer, Inc., --- F Supp 2d ----, 2005 WL 23307 (SD NY, Jan. 6, 2005). Thereafter, Pfizer agreed to stop its advertising campaign.

*2 On January 12, 2005, plaintiff brought this suit against Pfizer based on the same deceptive advertising campaign. Plaintiff, on behalf of herself and others similarly situated, now moves to certify a New York class action against Pfizer for violation of GBL § 349 and for common-law unjust enrichment for false statements and misrepresentations in Pfizer's marketing and advertising communications. Plaintiff proposes to represent this action on behalf of herself and " all persons or entities who purchased Listerine during the period from June 1, 2004, through the present."

DISCUSSION

Plaintiff argues that all the prerequisites in certifying a class action under CPLR 901 have been satisfied and that the court should certify the class under CPLR 902. This court is reminded that although the class action statute is liberally construed and read to favor the maintenance of class actions (*see Englade v. HarperCollins Publishers, Inc.,* 289 A.D.2d 159 [1st Dept 2001]), failure to make a showing of any of the requisite elements for class certification will result in the denial of the motion for certification (*see e.g. Reifen v. Nationwide Leisure Corp.,* 75 A.D.2d 551 [1st Dept 1980]). The court appraises each of the five prerequisites in turn.

A. *Numerosity*

Plaintiff must first demonstrate that the members of the class are " so numerous that joinder of all members, whether or otherwise required or permitted, is impractible" (CPLR 901[a][1]). Here, there is no dispute between the parties as to this element, and, accordingly, the first requirement is met.

B. *Commonality*

The second prerequisite the plaintiff must satisfy is to show that there " are questions of law or fact common to the class which predominate over any questions affecting only individual members" (CPLR 901[a][2]). In determining whether the plaintiff has satisfied this requirement, the court looks at the plaintiff's causes of action and determines whether each common question of law predominates over individual issues.

1. *GBL § 349*

The plaintiff alleges that Pfizer violated GBL § 349 by falsely representing that Listerine was " as effective as floss." In turn, plaintiff claims that this issue is common to the proposed class in such a way that it predominates over any question affecting only individual members, and, as such, certification is warranted. Defendant argues that, because questions of whether the false advertisements influenced the reasonable consumer to purchase Listerine and whether there was actual damage to each individual predominate over the common question of law, certification should be denied.

To have a viable claim under GBL § 349, a plaintiff must allege that the defendant engaged " in an act or practice that is deceptive or misleading in a material way and that plaintiff has been injured by reason thereof" (*Small v. Lorillard Tobacco Co.,* 94 N.Y.2d 43, 55 [1999]; *Solomon v. Bell Atlantic Corp.,* 9 AD3d 49, 52 [1st Dept 2004]). Deceptive or misleading representations or omissions are defined as those likely to mislead a reasonable consumer acting reasonably under the circumstances (*Solomon,* 9 AD3d at 52). Nonetheless, the deceptive act or practice must be " the actual misrepresentation or omission to a consumer" (*Goshen v. Mutual Life Ins. Co. of New York,* 98 N.Y.2d 314, 325 [2002]), by which the consumer is " *caused actual, although not necessarily pecuniary, harm* " (*Oswego Laborers' Local 214 Pension Fund v. Marine Midland Bank, N.A.,* 85 N.Y.2d 20, 26 [1995][emphasis added]). Thus, to prevail on a cause of action under GBL § 349, the plaintiff must show that the defendant made falsehoods or omissions that were likely to mislead a reasonable consumer in the plaintiff's circumstances, that s/he was deceived by those false statements or omissions and that, as a result, s/he was caused injury (*Goshen,* 98 N.Y.2d at 325).

***3** In turn, to satisfy the commonality requirement in a class action alleging deceptive acts and practices and false advertising, the proof must show that *each* plaintiff was reasonably deceived by the defendant's misrepresentations and was injured by reason thereof. The Court of Appeals has been clear that a plaintiff *need not show* that s/he *relied* on the misrepresentations in order to have a claim under GBL § 349 (*Stutman v. Chemical Bank,* 95 N.Y.2d 24, 29 [2000][emphasis added], citing *Small,* 94 N.Y.2d at 55-56; *Oswego,* 85 N.Y.2d at 26). However, to assert a GBL § 349 claim, a plaintiff must allege that s/he was *exposed* to the alleged misrepresentations (*Solomon,* 9 AD3d at 52 [emphasis added]). Therefore, class certification is not appropriate where " questions of whether each individual was exposed to, and influenced by, the advertising would predominate" (*Carnegie v. H & R Block,* 269 A.D.2d 145, 147 [1st Dept 2000], *lv. dismissed* 95 N.Y.2d 844).

On its face, Whalen's claims do appear to have a semblance of commonality since they are based on allegations that the defendant engaged in a general pattern of fraudulent conduct. However, class certification is not appropriate where the plaintiff cannot point to any specific announcement or pronouncement that was seen by all class members (*Solomon,* 9 AD3d at 53). Indeed, during her deposition, Whalen, the *proposed representative of the class,* admitted that she could not identify any commercial which influenced her to purchase Listerine. Furthermore, in open court, she admitted that she could not recall seeing any of Pfizer's alleged deceptive marketing ads, and that she was unfamiliar with the actual suit pending before this court. Where it cannot even be established that the proposed representative of the class was exposed to the alleged advertisements, it is questionable how Plaintiff proposes to demonstrate that all members of the class saw the advertisements. Thus, questions of individual members' exposure to the allegedly deceptive advertising predominate.

Furthermore, proof of injury is essential to a GBL § 349 claim. The court reiterates the point that while GBL § 349 " does not require proof of justifiable reliance, a plaintiff seeking compensatory damages must show that the defendant engaged in a material deceptive act or practice that *caused actual, although not necessarily pecuniary, harm* " (*Small v. Lorillard,* 252 A.D.2d 1, 7 [1st Dept 1998][emphasis added], quoting *Oswego,* 85 N.Y.2d at 26).

In this matter, each of the claims would require individualized proof concerning the various bases for liability and damages. First of all, though a reasonable individual could presumably be misled by the defendant's misrepresentations, the plaintiff has failed to demonstrate how defendant's false advertisement *caused her actual harm.* Indeed, it is undisputed that Whalen, who has been a regular user of the product for at least five years, continues to use Listerine after Pfizer's marketing effectively ended (*see* Smart Aff, Ex. 46). Furthermore, she continues to use floss without any change to her routine (*id.*). Finally, Whalen points out that she has not even seen the advertisements (*id.*). If anything, this only shows that Whalen was a consumer acting reasonably under the circumstances by being loyal to product brand, whether or not the marketing campaign was truthful or fraudulent (*see Oswego,* 85 N.Y.2d at 26). Though the court agrees with the plaintiff that there is no need to show reliance on the misrepresentation, the plaintiff must still show *actual harm.* Plaintiff has not done so.

***4** Further, assuming that individual plaintiffs purchased Listerine after being exposed to the ads, discontinued flossing, and suffered harm as a result, the extent of that harm and the correct measure of damages would require separate hearings. These plaintiffs would have to be distinguished from those plaintiffs who never used floss or flossed improperly so as to not get its benefits, and thereby could not have been injured as a result of using Listerine after seeing the ad. There may also likely be plaintiffs whose only harm was the purchase of the product after being exposed to the advertisements. Proof of purchase would be difficult given the unlikeliness that many of these plaintiffs maintained a receipt of purchase. If this court were to certify the class, an individual inquiry would be necessary to determine whether each plaintiff was actually harmed due to the deceptive acts of the defendant. Here, the question of violation of GBL § 349 as common to the class does not prevail over questions affecting only individual members. As such, the plaintiff fails to demonstrate commonality as to the GBL § 349 claim. [FN1]

FN1. The plaintiff, during oral argument and in her presentation of papers, strenuously argues that the decision in *Cox v. Microsoft* (Sup.Ct., Jul. 29, 2005) granting class certification is persuasive authority and similar to this case. She argues that *Cox* stands for the proposition that the only requirement to show commonality under GBL § 349 is that the statement itself was misleading, and not that she was misled. The decision in *Cox* is not only inapposite, but is misinterpreted. That case dealt with alleged anti-competitive conduct by Microsoft with its Windows operating systems, where plaintiffs alleged *actual* harm due to inflated prices and denial of a choice of products as a result of the conduct. In this case, there is no such assertion of *actual* harm. As the court in *Cox* aptly points out, " deception does not, in and of itself, constitute an injury" (*see also Small,* 94 N.Y.2d at 56-57).

2. *Unjust Enrichment*

Having failed to establish that the common issue of violation of GBL § 349 predominates over individual questions, plaintiff must show that the defendant was unjustly enriched by the false advertising and that this common issue of law surmounts individual questions. Again, plaintiff fails to demonstrate that this cause of action surpasses individual issues of law or fact.

In order to find that there was unjust enrichment on the part of the defendant, the plaintiff must show that: (1) the other party was enriched, (2) at that party's expense, and (3) that it " is against equity and good conscience to permit [the other party] to retain what is sought to be recovered" (*Citibank, N.A. v. Walker,* 12 AD3d 480, 481 [2d Dept 2004], quoting *Paramount Film Distributing Corp. v. State,* 30 N.Y.2d 415, 421 [1972]). However, if the plaintiff, acting with knowledge of the facts, pays for the product and continues to use the product, there is no unjust enrichment and recovery is barred (*see Dillion v. U-A Columbia Cablevision,* 100 N.Y.2d 525 [2003]).

Again, while on its face Whalen may have a cause of action, plaintiff does not show that commonality dominates over personal questions of liability and damages. Here, while Pfizer has profited from the sales of Listerine at the expense of the consumers, the plaintiff fails to explain how Pfizer was unjustly enriched by the sale of Listerine or how it is against equity to permit Pfizer to retain what is sought to be recovered. For one, the plaintiff does not indicate what type of damages the plaintiff is seeking. Indeed, while the plaintiff supplies the court with different methods and various calculations to estimate and determine damages (*see* Browne Aff.), the plaintiff fails to sufficiently explain what unjust enrichment Pfizer has actually derived from its sales of Listerine and what the plaintiff is entitled to recover. Furthermore, the plaintiff concedes that she has *no* evidence that Pfizer increased the price of Listerine before, during, or after the alleged false advertisements were made or otherwise received any inequitable financial gain from the product. In addition, the court notes that the plaintiff continues to use Listerine as her daily mouthwash, and will probably do so throughout this litigation. Even with knowledge of the misrepresentation, the plaintiff continues to purchase and utilize Listerine as part of her daily dental regime. Accordingly, the plaintiff is barred from claiming unjust enrichment.

***5** In turn, the plaintiff has not succeeded in demonstrating that this issue is common to all the class members and that it predominates over individual issues of law or fact. Again, the court would need to make an extensive inquiry into whether or not there was enrichment on the part of the defendant by individual class members. More importantly, the court would need to conduct an individualized inquiry into whether the class, acting with knowledge of the misrepresentations made by Pfizer, continued to purchase Listerine for their use. These individualized interrogations would predominate the issue common to the class, and, as such, does not allow the court to find commonality.

Because the plaintiff has failed to demonstrate that there are common issues of law or fact that predominate over any questions affecting only individual members, the court finds that plaintiff has not fulfilled the prerequisite requiring commonality pursuant to CPLR 901(a)(2).

C. *Typicality*

The third requirement for certification of a class action is that " the claims or defenses of the representative parties are typical of the claims or defenses of the class" (CPLR 901[a][3]). Plaintiff argues that her claims are typical of the claims of the class to be certified. The defendant contends that because the plaintiff has admitted that she " did not recall seeing" any of the commercials at issue, her claims are " atypical" and, thus, does not satisfy the third element for a class action.

In an action based on alleged misrepresentations, a named plaintiff's claims are atypical of a class if s/he did not rely on, or even see, these misrepresentations (*Small,* 252 A.D.2d at 10, quoting *Vermeer Owners, Inc. v. Guterman,* 169 A.D.2d 442, 443 [1st Dist 1991]).

Here, plaintiff has failed to show that her claims are typical of the claims of the class. While other proposed plaintiffs may have seen the advertisements, Whalen has not presented evidence that she relied on, or has even seen, these misrepresentations in her purchase of Listerine. Without reproducing the facts as articulated above, it is sufficient to point out that Whalen purchased the mouthwash long before Pfizer advertised that Listerine was " as good as flossing," continued to use the mouthwash during the time the marketing campaign was advertised to the public, and continues to use the mouthwash. Further, the plaintiff continues to utilize floss in addition to Listerine, and has not shown that she had done anything differently before or after the commercials and advertisements were used. Finally, the plaintiff does not recall seeing the advertisement or the marketing materials that were in the public during the period of time for which the class is being certified. This shows that the plaintiff did not see the commercials. Indeed, her claims are not typical of the claims the rest of the class would have, given that they would have at least seen the advertisements which contained defendant's alleged false representations.

***6** Accordingly, the plaintiff has failed to demonstrate that her claims are typical of the claims of the class, and fails to satisfy the third requirement for class certification under CPLR 901(a)(3).

D. *Representative Party*

The fourth requirement for certification of a class action is the necessity of a representative party that " will fairly and adequately protect the interests of the class" (CPLR[a][4]). The defendant argues that the plaintiff could not and would not represent the interests of the class because she had not seen the advertisements nor was damaged by these misrepresentations. Whalen reasons that because she has knowledge of the overall nature of the claims at issue, the plaintiff would adequately represent the class in this action. She cites *Brandon v. Chefetz* (106 A.D.2d 162 [1st Dept 1985]) for the preposition that she is " certainly qualified to act as a class representative" because she " has a general awareness of the claims." The court rejects plaintiff's argument.

In *Brandon,* the Appellate Division reversed the lower court's decision not to certify a class action because the court found that the plaintiff could adequately represent the class of shareholders against the officers of a corporation (*id.* at 165-166). There, plaintiff stockholders sued defendants for dominating and controlling the affairs of the corporation, transferring the value of stock from the shareholders to the defendants, and for breach of fiduciary duty (*id.* at 163-164). The court reasoned that, " in a sophisticated commercial case" such as that in *Brandon,* it was " not reasonable to expect that a layman ... would have detailed knowledge of the matters at issue" (*id.* at 170).

Here, the issues are misrepresentation by the defendant that Listerine is " as good as flossing" and the alleged unjust enrichment gained by Pfizer, not the " sophisticated commercial case" plaintiff seems to advocate. Unlike in *Brandon,* the court finds that it would be reasonable here for the plaintiff to have detailed knowledge of the matters at issue, namely, that Pfizer misrepresented the effectiveness of its product and that there was injury caused to the proposed class. The plaintiff has not seen the advertisements, had not shown that she suffered actual injury, continues to utilize the product, and does not even purport to speak for the class (*see* Smart Aff, Ex. 46). Furthermore, as gleaned from her deposition, plaintiff is unaware of the issues in this case and has not shown that she would be an adequate agent to the class. For instance, she does not know who the members of the class action are (*id.*). Further, she does not know what is involved in a class action, other than being generally cognizant that she represents a class (*id.*). Finally, the court questions whether the named plaintiff even has a general awareness of the action at bar.

The plaintiff has not shown that she will fairly and adequately protect the interests of the class and, accordingly has failed to satisfy the representative party requirement under CPLR 901(a)(4).

E. *Superiority of Action*

***7** The fifth and final prerequisite to certification of a class action is the demonstration that the " class action is superior to other available methods for the fair and efficient adjudication of the controversy" (CPLR 901[a] [5]). Here, plaintiff fails to present the superiority of the class action to other accessible methods.

The superiority requirement for a class action, similar to the commonality prerequisite, allows access to the courts for a group of plaintiffs who individually have claims and injuries common to the group, and the class provides equitable and effective determination of the controversy. " The essence of [the superiority] requirement ... is that in every instance where class treatment is sought, the proponent of the class must persuade the court that the provisions of Article 9 will serve their appropriate function in the particular situation and that the class suit is the best method of vindicating the rights of the members of the class." 2 Weinstein-Korn-Miller, N.Y. Civ Prac § 901.19, 9-67. After all, the class action is " a means of inducing socially and ethically responsible behavior on the part of large and wealthy institutions which will be deterred from carrying out policies or engaging in activities harmful to large numbers of individuals" (*Friar v. Vanguard Holding Corp.,* 78 A.D.2d 83, 94 [2d Dept 1980]). Without the benefit of the class action, these institutions could act with impunity in such matters " since, realistically speaking, our legal system inhibits the bringing of suits based upon small claims" (*id.*). Nonetheless, in determining superiority, judicial resources must be taken into consideration, especially where conducting individual inquiries would render the litigation " extremely difficult if not impossible to manage, and an inefficacious means of adjudicating any underlying common issue" (*see Gordon v. Ford Motor Co.,* 260 A.D.2d 164, 165 [1st Dept 1999]).

Here, as with any proposed class action, the effects would induce the " socially and ethically responsible behavior on the part of" Pfizer. It is also foreseeable that plaintiff's cause of action and damages will be a small claim, as it would be with members of the proposed class. The court agrees with the plaintiff that the class action would be superior over other forms of litigation to adjudicate the rights of the class had the plaintiff adequately shown that there were common issues of fact or law that predominated over individual questions of fact. However, the court is not convinced that class suit is the best method of vindicating the rights of the members of the class in this circumstance, especially where judicial resources are taken into consideration. Because the court would need to conduct extensive inquiry into the lives of individual members of the class in order to access injury and damages, it would be inefficacious and difficult to manage the litigation, and is not an appropriate use of judicial economy. The use of the class action is not, as such, superior to other available methods.

***8** Thus, the plaintiff has failed to show that the class action is the superior method over other available methods to litigation pursuant to CPLR 901(a)(5).

CONCLUSION

Based on the reasoning set forth above, the court finds that the plaintiff has failed to satisfy each of the prerequisites pursuant to CPLR 901 to certify a class action for violation of GBL § 349 and for the common-law claim of unjust enrichment. Accordingly, plaintiff's motion for class certification under CPLR 902 is denied.

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Slip Copy, 9 Misc.3d 1124(A), 2005 WL 2875291 (N.Y.Sup.), 2005 N.Y. Slip Op. 51779(U)

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Worldhomecenter.com, Inc. v. L.D. Kichler Co., Inc.
E.D.N.Y.,2007.

United States District Court,E.D. New York.
WORLDHOMECENTER.COM, INC., Plaintiff,
v.
L.D. KICHLER CO., INC., d/b/a Kichler Lighting, Defendant.
No. 05-CV-3297 (DRH)(ARL).

March 28, 2007.

Lawrence R. Lonergan, P.C., by Lawrence R. Lonergan, Esq., New York, NY, for Plaintiff.
Calfee, Halter & Griswold LLP, by John J. Eklund, Esq., William J. Michael, Esq., David A. Ruiz, Esq., Cleveland, OH, Ciarelli & Dempsey, by John L. Ciarelli, Esq., Riverhead, NY, for Defendant.

MEMORANDUM AND ORDER

HURLEY, Senior District Judge.

***1** Defendant L.D. Kichler Co., Inc. d/b/a Kichler Lighting (" Defendant" or " Kichler") moves to dismiss the complaint brought by Worldhomecenter.com, Inc. (" Plaintiff") for failure to state a claim, pursuant to Federal Rule of Civil Procedure (" Rule") 12(c). In the Complaint, Plaintiff seeks an order enjoining and prohibiting Defendant from engaging in further allegedly unlawful acts that violate the Sherman Act, 15 U.S.C. § 1; the Donnelly Act, New York General Business Law § 340; and the New York Deceptive Trade Practices Act (" DTPA"), New York General Business Law § 349. Plaintiff also seeks damages with regard to the alleged unlawful conduct. For the reasons that follow, Defendant's motion is granted in part and denied in part.

BACKGROUND

In crafting the following summary of facts, the Court accepts all of the factual allegations in the Complaint as true.

Plaintiff is a corporation formed under the laws of the State of New York with its principal place of business in Lynbrook, New York. It is an online retailer of home improvement products, selling to and servicing customers exclusively through its web site, known as " HomeCenter.com." Defendant is a foreign corporation with its principal place of business in Cleveland, Ohio. Defendant manufactures and sells lighting products exclusively to its authorized dealers.

Plaintiff purchases Kichler products for value from both exclusive and independent distributors for online resale to Plaintiff's customers. Because of the relatively low overhead and maintenance associated with on-line retailing, and because Plaintiff purchases a high volume of products from distributors, Plaintiff alleges that it is able to sell genuine Kichler products to consumers at sharp discounts compared to identical products offered for sale by traditional display room retailers.

Plaintiff has resold Kichler products over the Internet for several years without incident or complaint. On February 1, 2005, however, Defendant initiated an Internet Minimum Advertised Price (" IMAP") policy that is the basis for the present litigation. The policy provides, in pertinent part, as follows:

Kichler Lighting (" Kichler") has unilaterally adopted this Policy applicable to all Kichler customers effective February 1, 2005 with respect to the customer's advertising over the Internet of products supplied by Kichler.

1. Each Kichler customer remains free to establish its own resale prices. However, a customer may not A) advertise or otherwise promote Kichler Products over the Internet at a net price less than the Internet Minimum Advertised Price (" IMAP") Kichler establishes from time to time or B) sell Kichler Products to any other person who advertises or otherwise promotes Kichler products over the Internet at a net price less than the IMAP Kichler establishes from time to time. The initial IMAP Kichler has established is 1.8 times Distributor net price.

2. If a customer violates the policy, Kichler will withdraw from the customer all rights to sell, display or list Kichler Products on the World Wide Web for a period of six (6) months, and the customer will cease all sales, displays and listings within (30) days from the date of Kichler's notice to that effect.

***2** (Compl., Ex. A.) In addition to the IMAP policy, Plaintiff cites a " THIRD AND FINAL NOTICE" from Defendant advising its customers of potential penalties should any distributors fail to abide the

IMAP policy. This notice provides, in part:Dear Valued Customer:

Once again we are writing to inform you of a new policy from Kichler that will become *effective February 1, 2005*. We are instituting an Internet Minimum Advertised Price (I.M.A.P.) policy to help our dealers compete with companies that advertise our products at reduced prices on the web.

Due to the growth of the Internet channel of commerce, we are seeing more and more of our distributors losing sales to these low price Internet web sites. Our showrooms and electrical distributors make Kichler what it is today. We recognize the substantial financial investment you have made on our product line. With that investment in mind, it's just not possible to compete with the prices now being advertised on some Internet sites. Therefore we have created this policy to help protect our distributors, allow you to be competitive on the web, and to maintain the integrity of the Kichler line.

We'd like to reiterate one more time the responsibilities of our distributors that supply 3rd party websites. You, the dealer, must only supply web businesses that comply with Kichler's I.M.A.P. policy. If a distributor is found supplying a web site that does not comply with the policy, that distributor will suffer the consequences that are outlined in the policy. We are very serious about the enforcement of this policy, and would like to avoid any surprises.

(*Id.* Ex. B.)

This notice, together with the IMAP policy, serve as the entire basis for the present suit. According to the Complaint, " Kichler's IMAP policy effectively eliminates Plaintiff's ability to sell Kichler's products at a discount. Moreover, the end consumer of Kichler products is cheated the benefit of a more efficient distribution system...." (*Id.* ¶ 23.) Plaintiff further contends that " Kichler's IMAP policy is the result of multilateral communications between Kichler and its exclusive distributors, and constitutes an agreement to restrain trade." (*Id.* ¶ 24.) " By ' helping' and ' protecting' its dealers from competitive threats posed by Internet resellers, Kichler acknowledges a pact and a promise to preserve the margins enjoyed by Kichler and its distributors." (*Id.*) This alleged conspiracy, " allows Kichler to artificially maintain the price of its products and help its dealers compete with companies that advertise Kichler products for sale at reduced prices on the web." (*Id.* ¶ 25.) As such, " [t]he agreement among Kichler and its distributors effectively sets minimum resale prices or minimum advertised prices and constitutes vertical price fixing." (*Id.* ¶ 26.)

Plaintiff filed the present Complaint on July 13, 2005, based upon Kichler's alleged unlawful restraint of trade and minimum price maintenance. After filing an Answer, Kichler moved to dismiss the Complaint for failure to state a claim upon which relief could be granted. Plaintiff opposed the motion, and Kichler filed a reply memorandum.

DISCUSSION

I. *Rule 12(c) Standard*

***3** A motion for judgment on the pleadings pursuant to Rule 12(c) is evaluated under the same standard as a Rule 12(b)(6) motion to dismiss for failure to state a claim. *Nicholas v. Goord,* 430 F.3d 652, 658 n. 8 (2d Cir.2005). A plaintiff's claims can be dismissed for failure to state a claim only if a court finds that " it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson,* 355 U.S. 41, 45-46 (1957). In *Swierkiewicz v.. Sorema N.A.,* 534 U.S. 506 (2002), the Supreme Court emphasized that at the pleading stage, a plaintiff need only meet the standard set forth in Federal Rule of Civil Procedure 8(a), which requires only a " ' a short and plain statement of the claim showing that the pleader is entitled to relief.' " *See id.* at 512 (quoting Fed.R.Civ.P. 8(a)(2)). Thus, dismissal of a complaint pursuant to Rule 12(b)(6) is proper " only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations" set forth therein. *Id.* at 514 (citation and internal quotation marks omitted); *see also Amron v. Morgan Stanley Inv. Advisors Inc.,* 464 F.3d 338, 343 (2d Cir.2006) (" ' *All* complaints must be read liberally; dismissal on the pleadings never is warranted unless the plaintiff's allegations are doomed to fail under any available legal theory.") (quoting *Phillips v. Girdich,* 408 F.3d 124, 128 (2d Cir.2005)); *Leibowitz v. Cornell Univ.,* 445 F.3d 586, 591 (2d Cir.2006) (" [A] plaintiff is required only to give a defendant fair notice of what the claim is and the grounds upon which it rests."); *Twombly v. Bell Atlantic Corp,* 425 F.3d 99, 106 (2nd Cir.2005) (" At the pleading stage ... the issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims.") (citations and internal quotation marks omitted). This is not to say, however, that a plaintiff bears no pleading burden.

Rather " [a] plaintiff must allege, as the Supreme Court has held, those facts *necessary* to a finding of liability." *Amron,* 464 F.3d at 343 (citing *Dura Pharm., Inc. v. Broudo,* 544 U.S. 336, 346-47 (2005)).

II. *The Sherman Act Claim Survives the Motion to Dismiss*

Count two of the Complaint asserts a violation of Section 1 of the Sherman Act. The requirements of Rule 8 " notice pleading" as applied to claims under Section 1 are relatively modest and straightforward. Section 1 of the Sherman act proscribes " [e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations." 15 U.S.C. § 1. Thus, " a Section 1 plaintiff must allege that (1) the defendants were involved in a contract, combination, or conspiracy that (2) operated unreasonably to restrain interstate trade, together with the factual predicate upon which those assertions are made." *Twombly,* 425 F.3d at 113.

*4 Here, Defendant concedes, for purposes of this motion only, that Plaintiff has adequately alleged the existence of a conspiracy. (*See* Def.'s Reply at 2.) Indeed, this Court reached the same conclusion in a case with facts similar to the instant one. (*See Worldhomecenter.com, Inc. v. Thermasol, Ltd.,* No. 05 Civ. 3298, at 7 (E.D.N.Y. July 10, 2006) (finding that complaint adequately alleged agreement between manufacturer and distributors to fix price where " [t]he allegation is that [the manufacturer's] actions were not independent, and that independent actions of this ilk would be anomalous in the absence of some agreement between [the manufacturer] and its traditional distributors.").) Thus, the only question remaining is whether Plaintiff has sufficiently alleged an unreasonable restraint on trade.

The restraint alleged must be unreasonable either under a " per se" analysis or under the " rule of reason." *Tops Mkts., Inc. v.. Quality Mkts., Inc.,* 142 F.3d 90, 96 (2d Cir.1998). Generally there is a presumption against using the " per se" analysis. *See Bus. Elecs. Corp. v. Sharp Elecs. Corp.,* 485 U.S. 717, 726 (1988). Courts should only do so where the agreement at issue is so " manifestly anticompetitive" that its " pernicious effect on competition and lack of any redeeming virtue [is] conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm [it has] caused or the business excuse for [its] use." *Continental T.V., Inc. v. GTE Sylvania Inc.,* 433 U.S. 36, 50 (1977) (citation and internal quotation marks omitted). Examples of per se unlawful conduct include horizontal and vertical price-fixing [FN1] and certain type of group boycotts. *See NYNEX Corp. v. Discon, Inc.,* 525 U.S. 128, 133-34 (1998).

> FN1. " Restraints imposed by agreement between competitors have traditionally been denominated as horizontal restraints, and those imposed by agreement between firms at different levels of distribution as vertical restraints." *Business Elecs.,* 485 U.S. at 730.

Absent a " manifestly anticompetitive" scheme, the rule of reason analysis applies. Under this analysis, " an agreement will not violate the antitrust laws unless it can be shown that it will have an actual adverse effect on competition in the relevant market." *Elecs. Commc'ns. Corp. v. Toshiba Am. Consumer Prods., Inc.,* 129 F.3d 240, 244 (2d Cir.1997).

Here, Plaintiff alleges a restraint of trade in the nature of a vertical restriction between a manufacturer (Defendant) and distributors (including Plaintiff). In its opposition papers, Plaintiff asserts that the per se analysis applies to its claims and that it " is not making out any case to be determined by the ' rule of reason' analysis." (Pl.'s Mem. at 8, 14.) A vertical restraint is deemed to be per se illegal only if it contains an agreement to fix prices. *Business Elecs.,* 485 U.S. at 735-36. Courts have consistently distinguished between agreements among manufacturers and distributors that establish exclusive channels of distribution, which are presumptively legal, and agreements between manufacturers and distributors that intentionally fix the price of the manufacturer's products, which are presumptively illegal. *Elecs. Commc'ns.,* 129 F.3d at 245. Thus, " [i]n the absence of price-fixing, agreements to terminate distributors, even at the behest of competing distributors who seek to maintain exclusive distribution rights, have repeatedly been sanctioned by the courts." *Id.; see also id.* at 245-46 (" Manufacturers must enjoy some freedom to determine how to distribute their products without subjecting themselves to attack under the antitrust laws by disappointed distributors, absent activity that is manifestly anticompetitive.").

*5 Plaintiff alleges that the IMAP policy, which provides a minimum price at which distributors may advertise Defendant's products over the internet, constitutes an illegal price-fixing scheme designed to force internet resellers to maintain artificially high prices. Defendant counters that the IMAP policy cannot constitute a price-fixing agreement because by its very terms, it is expressly limited to *advertised* prices and unequivocally states that the distributors are free to establish their own resale prices.

Although the court recognizes that on its face, the IMAP policy only establishes minimum price levels with regard to advertised prices, Plaintiff alleges that the policy directly impacts the resale prices for internet distributors. An internet shopper only sees the advertised price of products on a website such as Plaintiff's. That shopper does not have the capability of visiting a " bricks and mortar" store for further investigation into the product and the price because that store does not exist. Therefore essentially, the advertised price is the retail price for an internet shopper. Thus although facially the IMAP restricts only advertising prices, construing Plaintiff's allegations as true, it has the concomitant effect of restricting retail prices for internet retailers as well.

Accordingly, the Court finds that the Complaint sufficiently alleges vertical price fixing, rendering the Sherman Act claim adequate to survive Defendant's motion to dismiss.[FN2]

> FN2. Defendant's reliance on *Worldhomecenter.com, Inc. v. Moen Inc* ., No. 05-CV-3296 (E.D.N.Y.2006) is misplaced as the defendant-manufacturer in that case did not institute an IMAP policy; rather, it refused to sell its new product line to Plaintiff.

III. *The Donnelly Act Claim Survives the Motion to Dismiss*

Defendant also moves to dismiss the Donnelly Act claim, essentially on the same grounds as its motion to dismiss the Sherman Act claim. The Donnelly Act declares illegal every contract, agreement, arrangement or combination whereby a monopoly is established or maintained, or whereby competition or the free exercise of any activity in the conduct of any business, trade or commerce is restrained. N.Y. General Business Law § 340(1). The Donnelly Act was patterned after the Sherman Act and has been narrowly construed to encompass only those causes of action falling within the Sherman Act. *See State v. Mobil Oil Corp.,* 38 N.Y.2d 460, 462-63 (1976); *see also Great Atl. & Pac. Tea Co., Inc. v. Town of East Hampton,* 997 F.Supp. 340 (E.D.N.Y.1998) (finding Donnelly Act is modeled after the Sherman Act and is generally interpreted in accordance with federal precedent). As a result, the Donnelly Act " should generally be construed in light of Federal precedent and given a different interpretation only where State policy, differences in the statutory language or the legislative history justify such a result." *X.L.O. Concrete Corp. v. Rivergate Corp.,* 83 N.Y.2d 513, 518 (1994) (citations and internal quotation marks omitted); *see also Stolow v. Greg Manning Auctions Inc.,* 258 F.Supp.2d 236, 244 n. 8 (S.D.N.Y.2003), *aff'd,* 80 Fed. Appx. 722 (2d Cir.2003).

Defendant concedes that Plaintiff's federal and state antitrust claims should be analyzed together. (Def.'s Mem. at 5 n. 1.) As such, Defendant urges the Court to dismiss Plaintiff's Donnelly Act claim based on the same objections it raised to the Sherman Act claim. *See Empire Volkswagon, Inc. v. World-Wide Volkswagon Corp.,* 814 F.2d 90, 98 (2d Cir.1987) (dismissal of Sherman Act claim required dismissal of Donnelly Act claim). For the reasons set forth in connection with the latter claim, the Court declines to do so.

IV. *The DTPA Claim is Dismissed*

***6** Finally, Defendant moves to dismiss the DTPA claim on the ground that Plaintiff has failed to allege that Defendant engaged in a deceptive practice. The DTPA prohibits " [d]eceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service...." N.Y. Gen. Bus. Law § 349(a). It contains a private right of action such that " any person who has been injured by reason of any violation of this section may bring an action in his own name to enjoin such unlawful act or practice, an action to recover his actual damages ..., or both such actions." *Id.* § 349(h).

To state a claim under the DTPA, a plaintiff must allege that " (1) defendant has engaged in an act or practice that is deceptive or misleading in a material way, and (2) plaintiff has been injured by reason thereof." *S.Q.K.F.C., Inc. v. Bell Atl. TriCon Leasing Corp.,* 84 F.3d 629, 636 (2nd Cir.1996). Deceptive acts and practices require a showing that a reasonable consumer acting reasonably under the circumstances would have been misled by the defendant's conduct.

Oswego Laborers' Local 214 Pension Fund v. Marine Midland Bank, N.A., 85 N.Y.2d 20, 26 (N.Y.1995). A mere allegation of " anticompetitive conduct alone will not suffice." *Leider v. Ralfe,* 387 F.Supp.2d 283, 295 (S.D.N.Y.2005).

In the Complaint, Plaintiff fails to allege a deceptive act by Defendant. The IMAP policy, though alleged to be anti-competitive, is not alleged to be deceptive. Accordingly, the Court grants Defendant's motion to dismiss the DTPA Act claim.

CONCLUSION

For the foregoing reasons, Defendant's motion to dismiss the Complaint is GRANTED in part and DENIED in part. The Court GRANTS Defendant's motion to dismiss the New York Deceptive Trade Practices Act claim, but DENIES Defendant's motion to dismiss the Sherman Act and Donnelly Act claims.

SO ORDERED.

E.D.N.Y.,2007.
Worldhomecenter.com, Inc. v. L.D. Kichler Co., Inc.
Slip Copy, 2007 WL 963206 (E.D.N.Y.), 2007-1 Trade Cases P 75,658

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